DOMESTIC POLITICAL LEGITIMACY OF TAX REFORM IN DEVELOPING COUNTRIES: A CASE STUDY OF TURKEY

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ABSTRACT

The influence of developed countries, intergovernmental organizations, and international tax experts on the domestic tax reform agendas of developing countries has increased since the end of World War II. The increasing influence of external actors constrains the sovereignty of developing countries in taxation. Thus, causing concern about legitimacy in tax reform. While much scholarly attention is devoted to assessing the effectiveness of tax reforms that have been implemented in developing countries, relatively little is paid to questioning legitimacy of tax reform. This paper argues for domestic political legitimacy of tax reform, focusing on whether the good governance condition that often came with development assistance after the 1990s is able to produce domestic political legitimacy of tax reform. This paper analyzes the recent tax reform efforts in Turkey, which considered public participation in the decision making procedure as part of good governance. It concludes that even though public participation in the tax policy and lawmaking process began with a concern for efficiency, public participation might become a basis for democratic taxation.

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I. INTRODUCTION

Tax reform is always in transition. As Wayne Thirsk pointed out, "As new ideas and fashions take hold, as the technology of tax collection changes and as a country's economic circumstances are altered, new opportunities will arise for improving a country's tax system."[1] Tax reform will be always at the forefront of the government agenda. However, Thirsk's truism does not describe the source of new ideas, fashions, and technological changes, or how a country's economic circumstances shift. The rising influence of developed countries,

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1 Wayne Thirsk, *Lessons from Tax Reform: An Overview* 28 (World Bank, Working Paper No. 576, 1991), *available at* http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1991/01/01/000009265_3960930154046/Rendered/PDF/multi_page.pdf.

intergovernmental organizations (IGOs),[2] in particular, the International Monetary Fund (IMF), the World Bank, and the Organisation for Economic Cooperation and Development (OECD), and their affiliated experts on domestic tax reform agendas have been extensively recorded in tax literature.[3] These scholars show that external actors have been the main source of tax reform in developing countries,[4] especially after World War II (WWII).

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[2] I use the term intergovernmental organization (IGOs) broadly to refer to international financial institutions (IFIs) (such as the IMF, and World Bank, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Bank for Reconstruction and Development, Inter-American Development Bank) and international governance organizations (most notably, the OECD). *See* MARGARET P. KARNS & KAREN A. MINGST, INTERNATIONAL ORGANIZATIONS: THE POLITICS AND PROCESSES OF GLOBAL GOVERNANCE 7 (2004); THE ROYAL INST. FOR INT'L AFFAIRS AND FORUM FOR THE FUTURE, INTERNATIONAL FISCAL INSTITUTIONS: ENHANCING THEIR ROLE IN PROMOTING SUSTAINABLE DEVELOPMENT (2002), *available at* http://www.oecd.org/dataoecd/47/7/2074704.pdf.

[3] Miranda Stewart, *Tax Policy Transfer to Developing Countries: Politics, Institutions and Experts*, *in* GLOBAL DEBATES ABOUT TAXATION 182 (Holger Nehring & Florian Schui eds., 2007) [hereinafter Stewart, *Tax Policy Transfers*] (showing the transfer of tax ideas to developing countries since the 1980s through a process of mass production of tax reform in the context of structural adjustment); Allison Christians, *Hard Law, Soft Law, and International Taxation*, 25 WIS. INT'L L.J. 325, 325, 331 (2007) (addressing the fact that OECD's declarations in tax matters may be accepted by some countries as largely equivalent to binding law); Allison Christians, *Global Trends and Constraints on Tax Policy in the Least Developed Countries*, 42 U.B.C. L. REV. 239, 239 (2009) [hereinafter Christians, *Global Trends*] (discussing how externally-developed tax trends such as the free trade movement, tax competition, and value added taxation have created significant constrains on the policy choices to the countries that are under development); Allison Christians, *Networks, Norms, and National Tax Policy*, 9 WASH. U. GLOB. STUD. L. REV. 1, 1, 4 (2010) [hereinafter Christians, *National Tax Policy*] (showing how nations use international tax networks like the OECD to share expertise and experience, emulate each other, and pressure each other to achieve common tax goals); Allison Christians, *Taxation in a Time of Crisis: Policy Leadership from the OECD to the G-20*, 5 NW. J. L. & SOC. POL'Y 19, 20 (2010) (discussing the extent to which a small group of established players continue to shape tax norms and practices throughout the world); Miranda Stewart, *Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries*, 44 HARV. INT'L L. J. 139, 143 (2003) [hereinafter Stewart, *Global Trajectories*] (analyzing how constraining tax norms are exported to developing countries by developed countries' governments directly through post-colonial reconstruction and aid projects and indirectly through their control of and contributions to the international institutions and related tax experts); Miranda Stewart & Sunita Jogarajan, *The International Monetary Fund and Tax Reform,* 2 BRIT. TAX REV. 146, 146 (2004) (focusing on the role and activities of the IMF in developing countries' tax reform surveying and analyzing the form and content of tax conditionality).

[4] The term "developing country" is used to describe countries that have a low level of development according to some criteria. However, there is no consensus about that criterion. The international institutions which publish lists to define the level of development of countries decide which criterion or criteria they will use. The World Bank uses the gross national income criterion. *How we Classify Countries*, WORLD BANK, http://data.worldbank.org/about/country-classifications (last visited May 15, 2012). Rather than being based on strict criteria, economic or otherwise, the IMF uses a classification that has evolved over time with the objective of facilitating analysis by providing a reasonably meaningful organization of data. *Country*

IGOs were founded as parts of the post-war world order. In July 1944, the United Nations Monetary and Financial Conference, commonly known as the Bretton Woods conference, brought together 730 policy makers from forty-five allied nations to provide a setting for post-war economic growth and avoid the problems which impeded the interwar global economy.[5] The IMF was established as a liquidity facility.[6] At the same time, the World Bank was established as a development institution.[7] A third body, the Organisation for European Economic Cooperation (OEEC), was formed in 1947 to administer American and Canadian aid under the Marshall Plan for the reconstruction of European economies after WWII.[8] The OEEC became

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Composition of WEO Groups, IMF, http://www.imf.org/external/pubs/ft/weo/2009/01/weodata/groups.htm (last visited May 15, 2012). Finally, the United Nations (UN) uses life expectancy at birth, adult literacy, education, combined gross enrolment ratio in education, and GDP per capita criteria to make the distinction. *International Human Development Indicators*, UNDP, http://hdrstats.undp.org/en/indicators/default.html (last visited May 15, 2012).

5 *See* Paul Wachtel, *Understanding the Old and New Bretton Woods* 3 (NYU Stern Sch. of Bus., Working Paper No. EC-06-20, 2007), *available at* http://w4.stern.nyu.edu/emplibrary/Florence_paper_jan4.pdf.

6 Article I of the IMF Agreement formulates the obligations of the Fund and its members in respect to the allocation of credit and internal adjustment. The emphasis on development objectives was added to the wording of Article I (ii) later: "To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." Articles of Agreement of the International Monetary Fund art. 1, July 22, 1944, 2 U.N.T.S. 39, *available at* http://www.imf.org/external/pubs/ft/aa/index.htm.

7 *See International Bank for Reconstruction and Development*, WORLD BANK, http://go.worldbank.org/SDUHVGE5S0 (last visited May 15, 2012).

8 *History*, OECD, http://www.oecd.org/pages/0,3417,en_36734052_36761863_1_1_1_1_1,00.html (last visited Feb. 10, 2010). The Marshall Plan (from its enactment, officially the European Recovery Program) was the United States (U.S.) primary program for rebuilding and creating a stronger economic foundation for European countries and thus repelling the threat of internal communism after WWII. U.S. officials expected that the improvement of living standards as a result of a strong economy would help the recipient governments raise enough political support against the local socialist/communist groups and thereby withstand the increasing influence of the Soviet Union in the region. In the other words, the Marshall Plan was the strategic weapon of the U.S. in the emerging Cold War. *See* BARRY MACHADO, IN SEARCH OF A USABLE PAST: THE MARSHALL PLAN AND POSTWAR RECONSTRUCTION TODAY 12 (2007), *available at* http://marshallfoundation.org/library/documents/Chapter_4.pdf; Burcak Keskin Kozat, Negotiating Modernization Through U.S. Foreign Assistance: Turkey's Marshall Plan (1948-1952) Re-Interpreted, at xv (2007) (unpublished Ph.D. dissertation, University of Michigan) (on file with author). Even though Turkey had not experienced destruction, as a vital military ally in the Cold War, facing intimidation by the Soviet Union, it benefited from the Marshall Plan and became a founding member of the OECD. The membership of Turkey in the OECD, which is known as the "Rich Man's Club," is based on this fact.

the OECD in 1961.[9] The aim of the OECD has been to help its member countries achieve sustainable economic growth and employment, and raise the standard of living in member countries while maintaining financial stability.[10] All of these goals are aimed at contributing to the development of the world economy, as well as contributing to sound economic expansion in member and non-member countries in the process of economic development.

Today, the IMF is an international organization counting 149 out of 184 emerging and developing countries among its members. The World Bank is an international organization of 144 out of 186 low-and-middle-income countries. The OECD helps policy makers in non-member developing countries from Africa, the Middle East, Asia, the Pacific, Latin America, and the Caribbean, "find innovative solutions to the global challenges of development, poverty alleviation and the curbing of inequality."[11]

Early in the process tax policy was identified as an essential component of the development policy.[12] Accordingly, tax reforms were implemented as a part of economic development projects and structural adjustment programs driven by the IMF and World Bank in developing countries. These institutions perceived two main roles for tax reform in developing countries.[13] First, as part of structural adjustment, tax reform was designed to reduce severe distortions in economic incentives and the resulting inefficiencies and inequities in the allocation of resources. Second, as part of efforts to stabilize the economy, tax reform was needed to generate public revenue in a reasonably non-distorting, equitable, and sustainable manner. Since the OECD member countries have an overwhelming majority of voting rights within the decision-

9 For a list of the current OECD members, see *List of OECD Member countries*, OECD, http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html (last visited May 15, 2012).

10 Convention on the Organisation for Economic Co-operation and Development Art. 1, Dec. 14, 1960, 12 U.S.T. 1728, 888 U.N.T.S. 141, *available at* http://www.oecd.org/document/7/0,3343,en_2649_201185_1915847_1_1_1_1,00.html.

11 *Development Centre*, OECD, http://www.oecd.org/department/0,3355,en_2649_33731_1_1_1_1_1,00.html (last visited May 12, 2012).

12 RICHARD M. BIRD, TAX POLICY AND ECONOMIC DEVELOPMENT 19 (1992).

13 ZMARAK SHALIZI, LESSONS OF TAX REFORM 3 (Sept. 1991), *available at* http://elibrary.worldbank.org/content/book/9780821319062.

making structures at the World Bank and the IMF, they make decisions in these two institutions as well.[14]

Tax reform has been promoted and used as a significant part of economic development projects and structural adjustment programs by the above mentioned IGOs. As a result of these efforts, the volume of tax reform efforts has increased in developing countries since WWII.[15]

The internationalization of tax reforms demonstrates that national tax reforms can no longer be viewed as purely national.[16] Leading global institutions are building an international fiscal architecture with law as its foundation.[17] This paper examines the international fiscal architecture by presenting a case study of the effect of IGOs on national tax reform in Turkey.

Turkey is a developing country which is affiliated with several IGOs.[18] Turkey became a member of the IMF and the World Bank in 1947 and has had a long term relationship with these international fiscal institutions (IFIs).[19] Turkey is also one of the founding members of the

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[14] Developing countries have 38 percent of voting the power at the IMF and 39 percent at the World Bank. ALDO CALIARI & FRANK SCHROEDER, REFORM PROPOSALS FOR THE GOVERNANCE STRUCTURES OF THE INTERNATIONAL FINANCIAL INSTITUTIONS 1 (2004), *available at* http://info.worldbank.org/etools/docs/library/57439/caliarischroeder.pdf. The executive board, which is responsible for conducting the day-to-day business of the IMF, consists of 24 Directors. Only the U.S., Japan, Germany, France, and the United Kingdom, who are also members of OECD, sit alone in a director's chair. The rest of the member countries are represented by 19 executive directors and they select director/directors as a group. For example, Austria, Belarus, Belgium, Czech Republic, Hungary, Kazakhstan, Luxemburg, Slovak Republic, Slovenia, and Turkey are a group and elect two directors and Brazil, Colombia, Dominican Republic, Ecuador, Guyana, Haiti, Panama, Suriname, and Trinidad and Tobago are another group and elect one director. *See generally Executive Directors and Voting Power,* IMF, http://www.imf.org/external/np/sec/memdir/eds.htm (last visited May 15, 2012). The same executive structure exists at the World Bank. *About Us*, WORLD BANK, http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20040580~menuPK:1696997~pagePK:51123644~piPK:329829~theSitePK:29708,00.html (last visited May 15, 2012).

[15] Stewart, *Global Trajectories*, *supra* note 3, at 141.

[16] *See* Terence C. Halliday & Bruce G. Carruthers, *The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalization of Corporate Insolvency Regimes*, 112 AM. J. SOC. 1135, 1173 (2007).

[17] *Id.* at 1135.

[18] Turkey is listed as a developing economy by the IMF; as a country with a high human development by the UN; and as an upper-middle-income economy by the World Bank. Turkey is not listed as an advanced economy by the IMF; as not country with a high human development by the UN; not as a high-income economy by the World Bank. These classifications imply whether a country is a developed country or not. Thus Turkey is clearly a developing country. *See* all sources, *supra* note 4.

[19] As of September 2006, World Bank commitments to Turkey had reached US$18.4 billion. The World Bank Group, *10 Things You Never Knew About The World Bank in Turkey*, WORLD BANK

OECD.[20] After Turkey began to lower its regulatory barriers to external trade and investment following WWII, the IGOs began taking control of Turkish tax reform.

The main objective of this paper is to analyze the dynamics influencing Turkish tax reform in order to demonstrate the role of external actors in developing countries' tax reform. Part II summarizes the major post-war Turkish tax reform in an analytic framework. This section is separated into four subparts covering four phases of the post-war period: 1950, 1960, 1980, and 2001. Part III discusses the external and internal actors involved in these tax reforms and shows how external actors broke the conceptual traditional past which perceives tax law as a sovereign entitlement of the state. Part IV analyzes the tax reform literature that has assessed the efficiency of tax reform backed by the IGOs and argues that domestic political legitimacy should be viewed as a new assessment criterion for tax reform. This Part focuses especially on how "good governance" conditions, which accompanied development assistance after the 1990s, can produce domestic political legitimacy in tax reform. Giving a concrete answer to this inquiry, Part V examines recent tax reform efforts in Turkey, which considered public participation in decision making procedures as a part of good governance. Part VI concludes that even though public participation in tax policy and the lawmaking process started with concerns about efficiency, this participation can become a basis for democratic taxation if developing countries take responsibility for their own economic and legal systems.

, http://digitalmedia.worldbank.org/tenthings/eca/turkey/10-tk.html (last visited May 15, 2012). Turkey is the biggest consumer of IMF loans. Turkey has had 19 stand-by agreements with the IMF. These agreements and their amounts are: 1961(37.5 SDR millions); 1962 (31 SDR millions); 1963 (21.5 SDR millions); 1964 (21.5 SDR millions); 1965 (21.5 SDR millions); 1966 (21.5 SDR millions); 1967 (27 SDR millions); 1968 (27 SDR millions); 1969 (27 SDR millions); 1970 (90 SDR millions); 1978-cacellation 1979 (300 SDR millions); 1979-cacellation 1980 (250 SDR millions); 1980 (1250 SDR millions); 1983 (225 SDR millions); 1984 (225 SDR millions); 1994 (610 SDR millions); 1999 (15038 SDR millions); 2002 (12821 SDR millions); 2005 (6662 SDR millions). *See* Ozlem Arpac & Graham Bird, *Turkey and the IMF: A Case Study in the Political Economy of Policy Implementation*, 4 REV. INT'L ORG. 135, 136 (2009).

[20] For relation with OECD, see OECD, *supra* note 9.

II. IDENTIFICATION OF MAJOR POST-WAR TAX REFORMS

The history of tax reform in Turkey has unfortunately not been well documented.[21] The main objective of this Part is to propose an analytical framework for the major tax reforms which have characterized the post WWII Turkish tax system. Since the major policy shifts in this period characterize economic developments, and tax policy is a part of economic development policy, major policy shifts also characterize tax reform. WWII Turkish tax reform may be divided into four phases, each beginning in 1950, 1960, 1980, and 2001.[22]

A. TAX REFORM IN THE 1950S

Turkey launched its first major post-war tax reform in 1950. This reform was the first to be initiated in a developing country after WWII.[23] The reform aimed to change the tax burden from indirect taxes to direct taxes by adopting modern income taxation.[24] In conformity with a commission led by a German-Turkish tax expert, a German-based modern personal income tax (PIT),[25] corporate income tax (CIT),[26] and

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21 Only a few scholars have worked on the topic of Turkish tax reform history. *See, e.g.,* NEZIH VARCAN, TÜRKIYEDE VERGI POLITIKALARININ OLUSUMU: CUMHURIYET DÖNEMI (1987).

22 An analytic framework of post-war Turkish economic development was proposed by Öniş and Şenses in their article. Ziya Öniş & Fikret Şenses, *Global Dynamics, Domestic Coalitions and a Reactive State: Major Policy Shifts in Post-War Turkish Economic Development*, 34 METU STUD. DEV. 251, 251 (2007) [hereinafter Öniş & Şenses, *Major Policy Shifts*], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1019997. I borrowed this analytic framework and applied it to post-war Turkish tax policy development.

23 *See* Fuat Andic & Arnold Reisman, Migration and Transfer of Knowledge: Refugees from Nazism and Turkish Legal Reform ¶ 46 (2007) (on file with author), *available at* http://s6.rewi.hu-berlin.de/online/fhi/articles/pdf-files/0707andic_reisman.pdf (last visited May 15, 2012).

24 In the 1950–51 budget, direct taxation was to produce 33.9 percent, and indirect taxation was to produce 66.1 percent of the total revenue. T. G. A. MUNTZ, TURKEY: ECONOMIC AND COMMERCIAL CONDITIONS IN TURKEY 10 (1951).

25 Gelir Vergisi Kanunu [Income Tax Act], Law No. 5421, T.C. RESMÎ GAZETE [R.G.] [Official Gazette of the Republic of Turkey] 1949, No. 7228.

26 Kurumlar Vergisi Kanunu [Corporate Income Tax Act], Law No. 5422, R.G. 1949, No. 7229. As opposed to the U.S. system, income has been taxed by several tax codes in Turkey. Since the inception of corporate taxation, Corporate Tax Law and Income Tax Law have existed together. Corporate tax has been levied on the income and earnings derived by corporations and corporate bodies. The income elements by Corporate Tax Law have been the same as those covered in the Income Tax Law. S*ee, e.g., id.* art. 1. "In other words, the Corporate Tax Law sets provisions and

tax procedure (TP)[27] codes were enacted by the Turkish Parliament.[28] Considering the low-income level and the difficulties of implementing modern income taxation requirements such as book-keeping, the Parliament also passed a separate law for a presumptive income tax on artisans and handcraftsmen.[29] These tax laws required a new tax administration, so the Turkish tax administration also reorganized.[30] The new laws enacted in this reform became the foundations of the modern Turkish tax system.

The new income tax featured a progressive rate scale ranging from 15 to 45 percent.[31] Taxable income included commercial incomes, wages and salaries, professional income, real estate earnings, securities savings, liquid investments, and other incomes. It exempted income derived from agriculture, the supply of mineral waters, fishing and hunting, author's royalties, musical composition and other fine arts, domestic labor, bonuses, indemnities, and certain other incomes.[32] There was a personal allowance of Turkish Lira (hereinafter TL) 540 to TL 1,440, depending on the size of family.[33] The corporate income tax imposed a rate of 10 percent on the net profits of capital associations and co-operative societies. A dividend tax also imposed a rate of 15 percent.[34] A foreign tax credit for shareholders' personal income was granted for giving taxpayers limited relief from double taxation.[35]

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rules applicable to the income resulting from the activities of corporations and corporate bodies, whereas the Income Tax Law deals with the income derived by individuals." *Turkish Taxation System*, GELIR IDARESI BASKANLIGI [REVENUE ADMINISTRATION], http://www.gib.gov.tr/index.php?id=469 (last visited May 15, 2012).

27 Vergi Usul Kanunu [Tax Procedure Act] Law No. 5432, R.G. 1949, No. 7234.

28 All these Acts came into force as of January 1, 1950 (for employees, 1951).

29 5425 sayili Esnaf Vergisi Kanunu (Artisan Tax Act of 5425). *See*, Varcan, *supra* note 21, at 71. There were other taxes re-adjusted at this time. These were: a petroleum tax on producing and refining companies (50 percent on net profits); an animal poll tax; an inheritance and gift tax; customs duties *ad valorem*; a transaction tax; a sugar excise; a tax on matches; a coffee excise tax; petroleum; liquid oil, electricity and gas consumption taxes; mining royalties; a transportation tax; and stamp duties and fees. Z. Y. HERSHLAG, TURKEY: THE CHALLENGE OF GROWTH 148 (1968).

30 Maliye Bakanlığı kuruluş ve görevleri [Organization and functions of the Ministry of Finance] Law. No. 5655, R.G. 1950, No. 7473

31 The lowest income bracket implemented up to TL 2,500, while highest tax bracket implemented up to TL 100,000. HERSHLAG, *supra* note 29.

32 *Id.*

33 *Id.*; MUNTZ, *supra* note 24.

34 MUNTZ, *supra* note 24.

35 *Id.* Muntz expected the negotiation of agreements with other countries for the avoidance of double taxation considering that the Turkish authorities gave consideration to tax credit. *Id.* However, Turkey waited until November 3, 1970 for its first double taxation agreement. The

Shortly after the 1950 tax reform, a new conservative government gained power. The new government implemented the new tax laws without much alteration of their content.[36] In spite of rising inflation in late1950s, the government did not adopt any major tax measures to try to raise more tax revenue.[37] On the contrary, the government gave several tax concessions, such as abolishing the artisan tax, and replacing the broad-based transactions tax on manufacturers' sales with a narrow-based excise tax on manufacturing inputs (e.g. cotton, yarn, fuel, electricity, plastics, and steel) in 1956.[38] On the other hand, the government did not adjust the bracket creep in personal income taxes caused by inflation, and as a result the income tax gradually increased over this time.[39]

B. TAX REFORM IN THE 1960S

The second instance of major tax reform coincided with the Turkey's first military coup, which occurred in 1960. The leaders of the coup established the National Unity Committee (NUC), which governed the country until power returned to civilians in October of 1961.[40] The NUC reenacted the PIT and TP codes with some revisions.[41] The main changes to income taxation included a re-extension of the PIT to the

double taxation agreement between Turkey and Austria started to implement incomes after January 1, 1974. *See* Gelir ve Servet Vergilerinde Çifte Vergilendirmenin Önlenmesine ve Diğer Bazı Hususların Düzenlenmesine İlişkin Anlaşma [Agreement between Republic of Austria and the Republic of Turkey for the Avoidance of Double Taxation with respect to Taxes on Income], Turk.-Austria, Nov. 3, 1970 [1973] R.G. 14612). Over the last three decades, Turkey has built up a double tax treaty network with more than 70 countries, including the United States. *See* Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Turk., Mar. 28, 1996, S. TREATY DOC. No. 104–30. A list of all of Turkey's tax treaties may be found on the Turkish Revenue Administration website. Çifte Vergilendirmeyi Önleme Anlaşmalari [Double Taxation Treaties], GELIR IDARESI BAŞKANLIĞI [REVENUE ADMINISTRATION] http://www.gib.gov.tr/index.php?id=1055 (last visited May 15, 2012).

36 Kenan Bulutoğlu & Wayne Thirsk, *Turkey's Struggle for a Better Tax System*, *in* TAX REFORM IN DEVELOPING COUNTRIES 326, 330 (Wayne Thirsk ed., 1997).

37 *Id*. at 331.

38 *See* Varcan, *supra* note 21, at 77-82; Bulutoğlu & Thirsk, *supra* note 36, at 331.

39 Bulutoğlu & Thirsk, *supra* note 36, at 331.

40 MELIHA BENLI ALTUNISIK & OZLEM TÜR KAVLI, TURKEY: CHALLENGES OF CONTINUITY AND CHANGE 32–33 (2005).

41 Gelir Vergisi Kanunu [Income Tax Act] Law No. 193, R.G. 1961, No. 10700; Vergi Usul Kanunu [Tax Procedure Act] Law No. 213, R.G. 1961, No. 10703. Since there were limited changes, the CIT did not reenact. There were limited changes, because Turkey had not completed its industrialization at that time, so there was not much complaint about the CIT.

agricultural sector;[42] raising the CIT rate from 10 to 20 percent; enacting investment deduction and accelerated depreciation provisions; adjusting the PIT rate brackets to a 10 to 60 percent range; and, adopting stronger administrative measures to fight tax evasion, such as requiring an annual declaration of wealth along with income tax returns.[43]

In 1961, a newly elected government came to power. This government reduced the income tax burden on farmers once again and provided new tax incentives to the business community to encourage investment and exports.[44] The new government also introduced a First Five Year Development Plan in 1962,[45] and enacted new tax changes to finance the plan. These changes increased customs duties on certain imports, introduced a general flat rate tax on all imports in the form of a stamp duty, created new taxes on foreign travel expenditures, transformed fees on real estate property transfer into a separate real estate purchase tax, and increased motor vehicle license taxes and fees.[46]

After the 1965 election, a new conservative government rose to power. Under this administration, the Parliament gave generous tax concessions to the business community by creating numerous exemptions to encourage private investment and assembly industries.[47] At the beginning of the 1970s, this conservative government introduced seven new taxes and increased existing tax rates across the board in order to recover revenue that had been lost from the erosion of the income tax base.[48] Later in the 1970s, tax adjustment was needed to offset the effects of rising price levels. However, weak coalition and minority governments were not able to undertake tax reform, and needed tax changes were not successfully introduced in the 1970s.[49] As a result, no additional major tax reforms were attempted until 1980.

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42 Gelir Vergisi Kanunu [Income Tax Act] Law No. 193, art. 52, R.G. 1961, No. 10700.

43 Vergi Ozel Ihtisas Komisyonu Raporu (Tax Specialist Commission Report) (1996), *available* at http://ekutup.dpt.gov.tr/vergi/oik510/; Bulutoğlu & Thirsk, *supra* note 36, at 326–27, 331.

44 Bulutoğlu & Thirsk, *supra* note 36, at 331.

45 *See* 1. BES YILLIK KALKINMA PLANI (THE 1ST FIVE YEAR DEVELOPMENT PLAN) (1963-1968), *available* at http://ekutup.dpt.gov.tr/plan/plan1.pdf (last visited Feb.20, 2010). In Turkish.

46 Bulutoğlu & Thirsk, *supra* note 36 , at 331.

47 *Id.*

48 *Id.*

49 *Id.* at 332.

C. TAX REFORM IN THE 1980S

Like the second major tax reform in the 1960s, Turkey's third major tax reform occurred in conjunction with a military coup.[50] The tax reform of 1980 followed the second direct military coup in Turkey.[51] During the military's new National Security Council (NSC) era, spanning from 1980 to the elections of 1983, several tax changes were introduced.[52] Personal income tax brackets and tax rates were adjusted upward. Tax rates increased from 10-68 percent to 40-75 percent for brackets up to the penultimate one, and from 60 to 66 percent for the top, open-ended bracket.[53] Advance income tax payments for self-employed taxpayers were put into effect.[54] Advance payments were implemented through a system based on estimated income during the year and determined by local tax commissions. The corporate tax rate was first unified at a 50 percent general rate (replacing three levies with a combined rate of 43 percent), with state economic enterprises (also known nonfinancial public enterprises) (SEEs) either subject to a 35 percent rate, or exempt from taxation.[55] These were later adjusted to a 40 percent rate for all corporations, including SEEs previously taxed at the preferential rate.[56] Investment and exportation were encouraged by

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50 *Id.*

51 *Id.*

52 For all the tax laws in this period, *see*, Varcan, *supr*a note 21, at 127-134. The first enacted laws –the Act of 2361 and 2362- were tax laws (RG: December 27, 1980/ 17203).

53 "In 1980, the tax exempt bracket amounted to LT 3,600 for wage earners (unchanged since 1967) and ten taxable income brackets ranged up to LT 1 million, with the highest on subject to a 69 percent marginal rate; taxable income in excess of LT 1 million was taxed at a 60 percent marginal rate. In 1981, the tax exempt bracket was raised to LT 61,200 and taxable incomes were grouped into seven brackets, with the lowest on up to LT 1 million, and the top one starting at LT 25 million." GEORGE KOPITS, STRUCTURAL REFORM, STABILIZATION, AND GROWTH IN TURKEY 15 (1987).

54 The advance income tax payments system was implemented to 1981 and 1982 incomes, but had to be abandoned shortly thereafter because of administrative difficulties and a strong negative reaction from public. *Id.* at 15 n.44; MUALLA ÖNCEL, AHMET KUMRULU & NAMI CAGAN, VERGI HUKUKU 325 (2010). However a new advance income tax payments system was enacted in 1985, and came into force in 1986, *see* Act of 3239 (RG: December 11, 1985/ 18955), Art. 65. According to the new system, corporations and self-employed taxpayers not subject to withholding tax were required to make quarterly income tax payments to one half of their value-added tax liability. *Id.*

55 KOPITS, *supra* note 53, at 15.

56 *Id.*

increasing the number of tax exemptions and exceptions in these areas.[57] As a result, the average of tax rebates on exports went from 9 percent in 1980 to 23 percent in 1983.[58]

Finally, the government enacted what is viewed as the second biggest tax reform in Turkey, the value added tax (VAT) in 1984.[59] The VAT became effective on January 1, 1985 at a rate of 10 percent on covered items.[60] The VAT replaced nine production taxes and other duties which had been imposed at various rates on specific groups of commodities and services. In the same year, all SEEs were made fully taxable.[61] As of 1985, the share of compensation for services in personal income tax revenue decreased to 46 percent as compared with 70 percent in 1979. However, the share of the compensation to employees for service rendered in the gross domestic product (GDP)[62] dropped from 33 percent in 1979 to 18 percent in 1985. In addition, indirect taxes were regressive and the price of SEE rose.[63]

D. TAX REFORM AFTER 2001

From the 1980s through the global economic crisis of 2001, Turkey experienced no additional major tax reforms. However, several tax changes took place after the crisis. Compared to the 1950, 1960, and 1980 tax reforms, this last era of tax reform has not been contained to a single reform effort, but was spread out over several years. The first step was indirect tax reform. Complex indirect taxation was simplified with the introduction of a special consumption tax in 2002.[64] The special

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57 Yeşim Arat, *Politics and Big Business: Janus-Faced Link to the State*, *in* STRONG STATE AND ECONOMIC INTEREST GROUPS: THE POST-1980 TURKISH EXPERIENCE 135, 142 (Metin Heper ed., 1991).

58 Tercan Baysan & Charles Blitzer, *Turkey's Trade Liberalization in the 1980s and Prospects for its Sustainability*, *in* THE POLITICAL ECONOMY OF TURKEY: DEBT, ADJUSTMENT AND SUSTAINABILITY 9, 13 (Tosun Aricanli & Dani Rodrik eds., 1990).

59 3065 sayılı Katma Değer Vergisi Kanunu (Value-Added Tax Act of 3065) (RG: November 2, 1984/18563).

60 *Id.* Art. 28 and 62.

61 KOPITS, *supra* note 53, at 15.

62 GDP is the market value of all final goods and services made within the borders of a country in a year.

63 Merih Celasun, *Fiscal Aspects of Adjustment in the 1980s*, in THE POLITICAL ECONOMY OF TURKEY: DEBT, ADJUSTMENT AND SUSTAINABILITY 15 (Tosun Aricanli & Dani Rodrik eds., 1990).

64 Special Consumption Tax Act of 4760 (RG: June 12, 2002; 24783), *available at* http://www.tbmm.gov.tr/kanunlar/k4760.html (last visited Sep. 1, 2011).

consumption tax replaced sixteen different taxes and duties, including taxes on oil products, vehicles, alcohol and tobacco products, and luxury consumer goods.[65] The next step was direct tax reform. At the end of 2004, the marginal PIT rate was reduced from 40 percent to 35 percent for wage income and from 45 percent to 40 percent for non-wage income.[66] The lower rate was implemented on income earned in 2005. In 2006, the structure of the personal income tax schedule was rearranged again by both reducing the tax rates and the number of tax brackets.[67] The new personal income tax schedule now consists of four tax brackets instead of five, and the new tax rates are 15, 20, 27, and 35 percent.[68] In addition, the different tariff schedules for wage and non-wage income have been unified.[69] The new tax rates and unified tariff schedule have been applied to both wage and non-wage income to be earned from January 1, 2006.[70] At the same time, a minimum living allowance on wage earners, which treated the family as a unit, was added to the

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65 Taxes repealed by the Article 18 of the Special Consumption Tax Act were: Akaryakit Tuketim Vergisi [Gas Consumption Tax], Akaryakit Fiyat Istikrar Payi [Gas Price Stabilization Contribution], Tasit Alim Vergisi [Motor Vehicle Purchase Tax], Ek Tasit Alim Vergisi [Additional Motor Vehicle Purchase Tax], Cevre Kirliligini Onleme Fonu [Environmental Pollution Prevention Fund], Trafik Tescil Harci [Traffic Registration Fee], Egitime Katki Payi [Education Aid Contribution], Ozel Islem Vergisi [Special Transaction Tax], Mera Payi [Meadow Contribution], Ek Vergi [Additional Tax], Federasyonlar Payi [Federation Contribution], Egitim, Genclik, Spor ve Saglik Hizmetleri Vergisi [Education, Youth, Sport and Health Service Tax], Malul, Sehit Dul ve Yetimleri Payi [Disabled, Martyr Widow and Orphan Contribution], Savunma Sanayii Destekleme Fonu [Defence Industry Support Fund], Tutun, Tutun Mamulleri ve Alkollu Ickiler Piyasasi Duzenleme Kurumu Payi [Tobacco, Tobacco Product and Alcoholic Drinks Market Regulation Board Contribution], Toplu Konut Payi [Social Housing Contribution] *Id.* art. 18.

66 5281 sayili Vergi Kanunlarinin Yeni Turk Lirasina Uyumu ile Bazi Kanunlarda Degisiklik Yapilmasi Hakkinda Kanun (the Act of 5281 on the Adjustment Tax Acts to the new Turkish Liras and Amendments in Some Other Acts) (RG: December 31, 2004; 25687 bis. 3), Art. 29.

67 5479 sayili Gelir Vergisi Kanunu, Amme Alacaklarinin Tahsil Usulu Hakkinda Kanun, Ozel Tuketim Vergisi Kanunu ve Vergi Usul Kanununda Degisiklik Yapilmasi Hakkinda Kanun (the Act of 5479 on Amending the Income Tax Law, Procedure of Collection of Public Receivables, Special Consumption Tax Law and Tax Procedure Law) (RG: April 8, 2006; 26133), Art. 1.

68 *Id.*

69 *Id.* From 1998 to 2006, income tax rates had been implied 5 percent lower for wage earners. The Turkish Court of Constitution declared the Act of 5479 which unified tariff schedules for wage and non-wage income null in 2010. According to the ability to pay principle in the Article 73 of the Turkish Constitution, wage earners should be favorably taxed than non-wage earners. Following the decision of the Court of Constitution, the government has broadened third and fourth tax brackets. However, this amendment has lowered tax burden for only high-wage earners and not brought any tax rate differences for wage-earners. See, Nami Cagan, Anayasa Mahkemesine Gore Ayırma Ilkesi ve Ucretlerin Vergilendirilmesi, in SARPER SUZEK'E ARMAGAN 3129-3132 (2011).

70 *Id.* Art 15 (1).

Turkish personal income tax system by a new law.[71] While the PIT law was amended through several changes, the CIT law was reenacted. A new Corporate Income Tax Act was adopted in 2006.[72] The 2006 CIT Act reduced the CIT rate from 30 to 20 percent and added some new regimes, such as advance pricing agreements and new rules for controlled foreign companies and for transfer pricing.

Another step was reform of the tax administration. The internal revenue service was restructured in 2005.[73] The General Directorate of Revenue was abolished and the Presidency of Revenue Administration was established as an agency within the Ministry of Finance.[74] The main institutional and organizational change that the law brought about was the establishment of a functionally semi-autonomous tax administration.[75] The tax policy function also shifted from the General Directorate of Revenue to the General Directorate of Revenue Policies, which was separately established under the Ministry of Finance in 2006 as one of the Ministry's main units.[76]

III. CONTEXT AND IMPETUS FOR POST-WAR TAX REFORMS

Tax reform has been an important part of development policies, so the context of tax reform has almost always been defined parallel to the evolution of development policies.[77] Scholars observed that developing country governments, with a few exceptions, operated on a similar model of development as the IGOs since WWII.[78] This alignment

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[71] 5615 sayili Gelir Vergisi Kanunu ve Bazi Kanunlarda Degisiklik Yapilmasina Dair Kanun (The Act of 5615 on the Amendments in Income Tax Act and Some Other Acts) (RG: April 4, 2007; 26483).

[72] 5520 sayili Kurumlar Vergisi Kanunu (The Corporate Income Tax Act of 5420) (RG: June 21, 2006; 26205).

[73] 5345 sayili Gelir Idaresi Baskanligi'nin Teskilat ve Gorevleri Hakkinda Kanun (The Law of 5345 on the Organization and Duties of The Presidency of Revenue Administration (RG: May 16, 2005; 25817).

[74] GELIR IDARESI BASKANLIGI [REVENUE ADMINISTRATION], TAXATION IN TURKEY 10 (2006), *available* at http://www.gib.gov.tr/fileadmin/user_upload/yayinlar/Taxation.pdf.

[75] *Id.*

[76] 5452 sayili Maliye Bakanliginin Teskilat ve Gorevleri Hakkinda Kanun Hukmunde Kararnamede Degisiklik Yapilmasi Hakkinda Kanun (The Law of 5452 on the Amendments in the Decree Law on the Establishment and Duties of the Ministry of Finance) (RG: February 7, 2006/ 26073), Art. 2, *available at,* http://www.tbmm.gov.tr/kanunlar/k5452.html (last visited Sep. 1, 2011).

[77] Stewart, *Global Trajectories*, *supra* note 3, at 141, 173.

[78] *See, e.g.*, Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World*, 33 INT'L LAW. 875, 875–76 (1999) (emphasizing that the Third

suggests that the impetus for changing development policy as well as tax policy does not significantly differ from country to country.

The role of the crisis has been recognized as being associated with tax reform, or in some cases, as a by-product of tax reform.[79] The role of economic crises in tax reform has been important. For example, the three major Turkish tax reforms all occurred after economic crises. The present section aims to describe and analyze the tax policy shifts incorporating external and internal actors with particular significance to the role of economic crisis.

A. TRANSITION TO A MULTI-PARTY SYSTEM AND LIBERALISM

From its inception until the multiparty elections on May 14, 1950 Turkey was under the control of a single-party government. The Republican People's Party (RPP) was established by the founding father of Turkey, Mustafa Kemal Ataturk, in 1923. Under the rule of the RPP a set of reforms were initiated to achieve top-down rapid modernization.[80] Since the 1923 Turkish Republic inherited the Ottomans' antiquated and inequitable tax system, tax reform was a piece of the new reforms. The tithe — a tax of 1/10 of the produce of the land — was abandoned in 1925 and a French style profit tax was adopted in 1926.[81] The French system was adopted after Turkish officials received training in France.[82]

The tax system became excessively complicated after WWII-period amendments were enacted with the goal of securing a quick revenue increase.[83] These amendments created a profit tax, which was a schedular income tax.[84] There was no tax on corporate income. Wage-earners carried the major burden of the income tax while higher-income groups, who earned mostly investment-related income, rarely paid

World has had the shared common decelerated national goal of development for nearly fifty years and calls the first development model in the 1950s and 1960s "Development Model I" and the second development model in the 1980s "Development Model II").

79 Bulutoğlu & Thirsk, *supra* note 36, at 333.

80 *See* E. FUAT KEYMAN & ZIYA ÖNIŞ, TURKISH POLITICS IN A CHANGING WORLD: GLOBAL DYNAMICS AND DOMESTIC TRANSFORMATIONS 12–13 (2007).

81 Varcan, *supra* note 21, at 32.

82 *See* Ahmet Hamdi Başar, *Vergi Reformu* [*Tax Reform*], in TURKIYE IKTISAT KONGRESI [ECONOMICS OF TURKEY] 269 (1948), *available at* http://ekutup.dpt.gov.tr/ekonomi/iktisa48/ikt48-4.pdf.

83 Bulutoğlu & Thirsk, *supra* note 36, at 326.

84 In a schedular system of taxation, income is divided into different categories or sources and each sources being subject to its own computation rules and, in some cases, tax rates. IBFD, INTERNATIONAL TAX GLOSSARY 355 (Barry Larking ed., 2001).

income taxes.[85] The piecemeal remedial changes and ad-hoc amendments did not solve the Turkish budgetary problems, nor did they meet economic development goals. As a result, plans for a new tax reform came to order in the government agenda.[86]

In addition to the insufficient tax system, the transition to a multi-party system in 1946 created an important domestic dynamic behind the new tax reform attempt. The Democrat Party (DP) was established on January 7, 1946 and ended the single-party era. The DP announced that tax reform was needed to spread the burden of taxation more equitably.[87]

Fritz Neumark, a dual citizen of Turkey and Germany and tax expert,[88] together with Turkish government officials, played a major role in writing new tax laws.[89] The Ministry of Finance made the tax legislation projects public creating fierce public debate, especially from those whose tax burden would be increased (i.e. business and large farmers).[90] After a year of discussions in the media, radio programs, chambers of commerce, and industry, the tax legislation proposals were passed by the Parliament. They came into force at the beginning of 1950.[91]

Although substantial improvements were made in the tax system in 1949 through the adoption of a global personal income tax and a separate tax on corporate income, one point attracted a multitude of critics: the exemption of agriculture from income taxation.[92] This reform would exempt more than 1/3 of the nation's GDP from taxation, since

85 MUNTZ, *supra* note 24.

86 *See* Fritz Neumark, *Vergi Reformu* [*Tax Reform*], in TURKIYE IKTISAT KONGRESI [ECONOMICS OF TURKEY] 325, 325–26 (1948), *available at* http://ekutup.dpt.gov.tr/ekonomi/iktisa48/ikt48-4.pdf.

87 *See* Varcan, *supra* note 21, at 68.

88 Frizt Neumark was one of the most prominent economists specializing in public finance who had known with "the Neumark Report," which gave birth to the value-added tax. *See* PAUL FARMER & RICHARD LYAL, EC TAX LAW 17 (1994). He was one of the 190 eminent intellectuals who immigrated to Turkey in order to escape the Nazi regime. A professor at the University of Frankfurt, he fled from the Nazi regime and came to Turkey in 1933. He later became a Turkish citizen. He stayed until 1951. After his return to Germany, he served the German government and the OECD as well. Neumark's greatest impact on Turkey was in the field of taxation. *See* Andic & Reisman, *supra* note 23, ¶¶ 30–32.

89 Andic & Reisman, *supra* note 23, ¶ 42.

90 *Id.* ¶ 44.

91 *Id.*

92 *See* Bulutoğlu & Thirsk, *supra* note 38, at 364.

agriculture represented 40 percent of the GDP.[93] The Ministry of Finance explained that agriculture was exempted because it was too difficult to determine profits in the agriculture sector.[94] According to Neumark, and other commentators, this reasoning was invalid because only a few large farms existed. In other words, compliance measures could reasonably be targeted to a very manageable number of taxpayers.[95] The exemption of agriculture income could be interpreted as an incentive to continue the existing economic and political structure, as well as being an example of the influence of external actors on national policy making.

After a brief period of economic laissez-faire in the 1920s,[96] "etatism" came into existence in Turkey. The "etatism" or "statism" doctrine appeared in 1890 in France and was further defined by French writers in the 1920s.[97] Etaism means "central financing of development through the national budget, combined with State control and ownership of vital economic resources, including large sectors of industry, and the subordination of the private interests of producers and consumers to considerations of accelerating the pace of national economic development."[98] Turkey switched to this system as a result of the worldwide distrust of markets in the 1930s.[99] After WWII, the Turkish government began to transform etatist policies into liberal policies, which called for integration into the world market on the basis of agricultural exports.[100]

The United States played a major role in this transition. The political influence of the United States grew in Turkey after 1947,[101] particularly due to Turkey's shared border with the former Soviet Union.

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93 *See*, Gulten Kazgan and Haydar Kazgan, Turkiye'de Maliye Politikasi 1950-1960 14 (1964), as cited in Varcan, *supra* note 21, at 83.

94 *See* Varcan, *supra* note 21, at 72.

95 *See* Neumark, *supra* note 86, at 330; Muntz, *supra* note 24.

96 Anna O. Krueger, *Partial Adjustment and Growth in the 1980s in Turkey*, *in* REFORM, RECOVERY, AND GROWTH: LATIN AMERICA AND THE MIDDLE EAST 343, 345 (Rudiger Dornbusch & Sebastian Edwards eds., 1995).

97 ROGER SCRUTON, A DICTIONARY OF POLITICAL THOUGHT 156 (1996).

98 HERSHLAG, *supra* note 29, at 139.

99 *See* DILEK BARLAS, ETATISM AND DIPLOMACY IN TURKEY: ECONOMIC AND FOREIGN POLICY STRATEGIES IN AN UNCERTAIN WORLD, 1929–39, at XI (1998).Other countries of the region, such as Hungary, Poland, Rumania, Yugoslavia, Bulgaria in Eastern Europe and the Balkans, and Iran in the Middle East, followed similar policies in the 1930s, after the collapse of the world economic order. *See id.*

100 *See* Öniş & Şenses, *Major Policy Shifts*, *supra* note 22, at 263.

101 *See* KEMAL KARPAT, TURKEY'S POLITICS: THE TRANSITION TO A MULTI-PARTY SYSTEM 189 (1959); BERCH BERBEROGLU, TURKEY IN CRISIS: FROM STATE CAPITALISM TO NEO-COLONIALISM 70–71 (1982).

As a result Turkey was viewed as a critical ally to the United States in the Cold War era.[102] Officials in the United States expressed a belief that European economic recovery could be achieved only by following a U.S.-type economic modernization. This type of economic modernization called for obtaining advanced U.S. machinery and technical expertise in the agricultural and industrial fields as well as in business and labor management.[103] The first period military aid started in 1947 under the Truman Doctrine, and later in 1948 economic aid was given through the Marshall Plan. The United States exercised "a certain moral pressure" on Turkey to open up the Turkish economy.[104] The Thornburg Report[105] and the International Bank for Reconstructions (IBRD) (namely World Bank) Report[106] criticized the etatism strategy of Turkey from the viewpoint of the liberal economy.

The Thornburg Report was an extensive economic survey of Turkey written by a team of American specialists headed by Max Weston Thornburg.[107] The team was commissioned by the Twentieth Century Fund which is a nonprofit public policy research institute in the United States.[108]

The IBRD report was prepared by a technical advisory mission of the World Bank, which spent three months in Turkey, from June to September 1950.[109] According to the report's terms of reference, the mission's purpose was a broad survey of the Turkish economy. The aim of the report was to enable the bank to make recommendations to the Turkish government on long-term policies appropriate to development policies.[110]

In his preface, Thornburg wrote:

> that the government of Turkey and the people themselves wish American aid in effective forms, and therefore that so far as they can, they will bring about

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[102] *See* Kozat, *supra* note 8, at 90.
[103] *Id.* at 14.
[104] KARPAT, *supra* note 101, at 299.
[105] *See* MAX WESTON THORNBURG ET AL., AN ECONOMIC APPRAISAL, at viii (1949).
[106] *See* Int'l Bank for Reconstruction and Dev., *The Economy of Turkey: An Analysis and Recommendations for a Development Program*, at 226–27, IBRD DOC. 1951.1 (1951) [hereinafter IBRD Report].
[107] THORNBURG, *supra* note 105.
[108] *Id.*
[109] IBRD Report, *supra* note 106, at xi.
[110] *Id*. at xii.

> such internal conditions as will make that aid possible .. . . Turkey must adopt methods suited to its own conditions – even though not necessarily to ours – if it wishes to achieve the same type of individual and national freedom at which our own national policy aimed. If Turkey does not wish freedom, American aid will not be useful either to Turks or to American policy.[111]

The idea of establishing close ties with the United States to accomplish Turkey's historical objective of modernization was also predominant in Turkish intellectual circles at that time.[112] As a result, both the ruling RPP and the opposing DP adopted liberal economic policy views.[113] People were angry with single-party rule, and the shortages of WWII were attributed to bad governance by the RPP.[114] The 1950 election cry of the DP was to portray themselves as "being little America," which reflected the DP party's American view.[115] This appeal was successful as the DP became the dominant party in the election. After this rise, the DP continued to support liberal policies.

After a promising beginning to DP rule in 1950, the Turkish economy encountered increasing problems during the course of the 1950s particularly when export led growth ended in 1953. Export-led growth stopped as a result of the end of the Korean War commodity boom and the shift of resources to the buoyant domestic market.[116] Inflation accelerated, and balance-of-payments difficulties mounted.[117] As a consequence of these changes, a major economic crisis occurred in the late 1950s.[118]

To cope with growing strains in its balance of payments and public sector deficit, the first IMF-supported stabilization program was

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[111] *See* THORNBURG, *supra* note 105, at viii.
[112] *See* Kozat, *supra* note 8, at 16.
[113] *See* Mete Tunçay, *Siyasa Hayat: Siyasal Gelismelerin Evreleri*, IN CUMHURIYET DONEMI TURK ANSIKLOPEDISI (ED. MURAT BELGE, 1983)
[114] *Id.*
[115] *See* Tevfik Çavdar, *Demokrat Parti*, IN CUMHURIYET DONEMI TURK ANSIKLOPEDISI (Murat Belge ed., 1983) (summarizes the Democrat party era in Turkish political life)
[116] Krueger, *supra* note 96, at 346.
[117] Keyman & Öniş, *supra* note 80, at 105.
[118] *Id.*

put into practice in August of 1958.[119] The key elements of the stabilization program were: a major devaluation; immediate import liberalization and rationalization of import licensing schemes; ceilings on government expenditures, credit, and the money supply; and an increase in prices of commodities produced by SEEs, with the removal of price controls over most items for the private economy.[120]

The government followed the program in the beginning, but later violated some provisions of the program. The violation of the program did not last very long.[121] The military seized power in May 1960 and Turkey recommitted to the major provisions of the stabilization program.[122] Democracy received some severe setbacks, but the hindrance to IMF-supported stabilization program was eliminated.

B. THE MILITARY COUP OF 1960 AND RECALLING ETATISM

The 1960 coup was carried out by the Turkish military, which was modernized extensively with the aid of the United States.[123] After seizing control, the military authorities prepared a new Constitution of 1961.[124] This new Constitution placed a major emphasis on the extension of social rights and the idea of planned economic development.[125] As a part of a planned economy, the State Planning Organization (SPO) was created to formulate and implement rational economic development policies.[126] This new approach gave the state the key role of being the major agent for economic and social transformation.[127] This followed a

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[119] Turkey had held discussions with the IMF prior to the agreement. The first meeting of the IMF in Turkey was the Annual Meetings of the IMF and the World Bank of 1955. Turkey hosted the meetings again in 2009. Deputy Prime Minister and Governor of the Fund for Turkey, Ali Babacan, announced that Turkey is the only country apart from the U.S., where the IMF and the World Bank are headquartered, to have hosted the meetings twice, and emphasized the evolution of Turkey comparing economic development of Istanbul in 1955 and 2009, *see*, Caroline Atkinson, *A Generous Host- Twice*, http://blog-imfdirect.imf.org/2009/10/01/a-generous-host%E2%80%94twice/ (last visited Mar. 5, 2010).

[120] Krueger, *supra* note 96, at 346 and 347.

[121] *Id.*

[122] *Id.*

[123] *See* Machado, *supra* note 11, at 86.

[124] 1961 tarihli Turkiye Cumhuriyeti Anayasasi (The Turkish Constitution of 1961) (1961 AY). For the text in English, s*ee*, SADIK BALKAN, AHMET E. UYSAL & KEMAL H. KARPAT (TRANS.), CONSTITUTION OF THE REPUBLIC (1961), *available* at http://www.anayasa.gen.tr/1961constitution-text.pdf (last visited Mar. 1, 2010).

[125] 1961 AY, Art. 41.

[126] 1961 AY, Art. 129.

[127] Öniş & Şenses, *Major Policy Shifts, supra* note 24, at 16.

policy of import substitution, i.e. a prohibition on imports of commodities for which domestic production was deemed adequate.[128] This caused the government to increase the importance of SEEs.[129] This shift in Turkish development policy was responsive to the global development model of the 1960s.[130] In that decade, it seemed likely that officials in all developing countries believed that national governments had the primary responsibility for bringing about economic development.[131] The IFIs became open to the idea of infant industry protectionism, or at least of fostering rapid industrialization and development.[132] In fact, the Turkish State Planning Organization (SPO) explicitly stated that external actors had a role in its organization.[133] The 1958 economic crisis also helped to produce the necessary political space within which the new strategy could be institutionalized.[134] A domestic coalition among the rising industrialists of the 1960s characterized by their transition from landownership or commercial entrepreneurship to industrial entrepreneurship, the bureaucratic elite, and organized labor, was also in the favor of the new development strategy.[135]

Later on during the 1960 tax reform, the military returned the power to civilians in the 1961 election. Keyman and Öniş stated that "restoration of democracy has brought to the surface the accumulated distributional claims, thus, marking the upward trend in the populist cycle."[136] This statement exemplifies the immediate changes following the tax reform of 1960. Because of the fierce public debate over the recent changes, the new government established the Tax Reform Commission to review all the tax codes.[137] In accordance with the Tax

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[128] Krueger, *supra* note 96, at 343.

[129] *Id.*

[130] See Salacuse, *supra* note 78, at 877.

[131] *Id.*

[132] Öniş & Şenses, *Major Policy Shifts*, *supra* note 24, at 16.

[133] "The international organization which wanted the consistency and coordination with foreign aid of Turkish economic policy also brought in the idea of coordination and macro planning in this era (1960)." Devlet Planlama Teskilati, *1960 Oncesi Donemde Planlama* (Organization Before the 1960 Era), http://www.dpt.gov.tr/PortalDesign/PortalControls/WebIcerikGosterim.aspx?Enc=83D5A6FF03C7B4FCA608B4A8502F95DC4B0813776FCA14B256788CDF49C1D36D (last visited Sep. 1, 2011).

[134] Öniş & Şenses, *Major Policy Shifts, supra* note 24, at 16.

[135] *Id.*

[136] Keyman & Öniş, *supra* note 80, at 103.

[137] Varcan, supra note 21, at. 96.

Reform Commission's recommendations, the distribution of the tax burden became once again inequitable.[138]

The new economic policy had a successful start. The Turkish economy grew rapidly during the period of the First and Second Five-Year Development Plans (1963-67, and 1968-72).[139] The policy accomplished substantial structural change such as the production of industrial enterpreneurship.[140] By the late 1970s, however, Turkey once again encountered balance of payments difficulties and rising inflation.

C. THE MILITARY COUP OF 1980 AND EMBRACING NEO-LIBERALISM

In the years following 1975, the economic situation in Turkey declined. The inflation rate accelerated.[141] While many of the industrialized economies were taking painful steps to adjust their economies against rising oil prices, Turkey pursued a policy of rising investment, with the support of the foreign exchange reserves, and an accommodating monetary policy.[142] This policy cost Turkey very much economically, particularly as Turkey became unable to meet its external commitments. At the end of the 1970s there was a general opinion among external actors that the ISI model was no longer working, and as a result neo-liberalism became the hegemonic development discourse throughout the world.[143] External actors insisted upon fundamental changes in developing countries' economic policy with a set of new policies known as the "Washington Consensus."[144] The Washington Consensus required the elimination of budget deficits, strict control of the money supply, deregulation, privatization of state-owned enterprises, and openness to international trade and investment.[145] In the case of Turkey, IFIs forced the new development model.

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138 Bulutoğlu & Thirsk, *supra* note 36, at. 365.

139 World Bank, Turkey: Prospects and Problems of an Expanding Economy 7 (1975).

140 Öniş & Şenses, *supra* note 22, at 17.

141 Krueger, *supra* note 96, at 349.

142 Roger Owen & Sevket Pamuk, A History of Middle East Economies in the Twenty Century (1998).

143 Salacuse, *supra* note 78, at 882.

144 This consensus is also named the 'one world consensus,' because not only developing countries but also industrial countries have embraced its principles. Jean Waelbroeck, *Half a Century of Development Economics: A review Based on the Handbook of Development Economics*, 12(2) THE WORLD BANK ECONOMIC REVIEW 323 (1998).

145 Salacuse, *supra* note 78, at 883.

After 1980, Turkey transitioned from an import-substituting industrialization economic strategy to a neo-liberal economic strategy with emphasis on liberalization and de-regulation.[146] Economic policy change came with a change in politics too. Turkey adopted this new model under the military rule. IGOs like the IMF, the World Bank, and the OECD were collectively involved in Turkey's neo-liberal structuring process.[147] In accordance with these facts, the IGOs played a major role in initial tax reform in 1980.

Bulent Ecevit, Turkish Prime Minister, and leader of the Republican People's Party, was appointed to form a new government after the 1973 and 1977 elections. The Ecevit government, in power from 1973 to 1979, did not call upon the IMF until 1978 because it believed that obtaining support from the IFIs was counter to total economic independence and anti-imperialism.[148] Nonetheless, Ecevit asked for IMF cooperation as a last resort.[149] The IMF and the Turkish Government arranged a standby agreement covering a two-year period from 1978 to 1980.[150] The conditions of the agreement were not met and another stand-by agreement was approved by the IMF in 1979.[151] The Turkish government again failed to fulfill the conditions for following the new standby agreement. Economic crisis led to rapid inflation which resulted in large increases in wage and salaries causing most taxpayers to be placed into income brackets subject to very high marginal rates.[152] This development brought steady erosion of work and savings incentives and created widespread tax avoidance and evasion.[153] During the period from 1978 to 1980, the government rarely presented tax packages to Parliament, nor did Parliament pass a tax package.[154]

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[146] Öniş & Şenses, *Major Policy Shifts*, *supra* note 22, at 18.

[147] *See* Peter Wolff, Stabilization Policy and Structural Adjustment in Turkey, 1980-1985: The Role of the IMF and World Bank in an Externally Supported Adjustment Process 1 (1987); Öniş & Şenses, *Major Policy Shifts*, *supra* note 22, at 18.

[148] *See* Osman Okyar, *Turkey and the IMF: A review of Relations*, 1978-82, in IMF CONDITIONALITY, 540 (John Williamson ed., 1983).

[149] *Id.*

[150] Merih Celasun & Dani Rodrik, *Debt, Adjustment, and Growth: Turkey* in DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE: COUNTRY STUDIES-INDONESIA, KOREA, PHILIPPINES, TURKEY 757 (1989).

[151] *Id.*

[152] *See* Bulutoğlu & Thirsk, *supra* note 36, at. 367.

[153] Kopits, *supra* note 53, at 15.

[154] A tax reform bill was introduced in 1978, but was not approved. *See*, World Bank, Report And Recommendation Of The International Bank For Reconstruction And Development To The Executive Directors On A Structural Adjustment Loan (Supplement) To The Turkey 12

The Demirel government succeeded the Ecevit government in November of 1979. The Prime Minister Suleyman Demirel appointed Turgut Ozal as planning under secretary. Özal was formerly a member of the SPO staff and later a member of the Turkish Industrialists' and Businessmen's Association (Turk Sanayicileri ve Isadamlari Dernegi-TÜSİAD),[155] as well as the one time President of the Metal Industrializations Union, and a top-level executive in a Turkish holding company (Sabancı Holding Company).[156] Ozal and a ten person team of bureaucrats prepared an economic stabilization program.[157] The Demirel government accepted and announced the Ozal group's program on January 24, 1980.[158] The program had major policy objectives, which drove the Demirel government's determination to reorient the Turkish economy.[159] This reform program actually meant the collapse of the ISI and the rise of the neo-liberal model, with particular emphasis on liberalization and de-regulation.[160] The reform program was a radical departure from economic policies pursued by Turkey during the previous two decades.[161]

External actors were involved in this transition. Even though the January 1980 program was announced before the IMF agreement in June 1980, Demirel had contact with the IMF through his officials after forming his government in November 1979.[162] An IMF team visited Turkey at the beginning of December 1979 and Demirel sent Ozal to

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(October, 30 1980) [hereinafter World Bank Supplement Report of 1980], *available* at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/09/02/000178830_98101902362115/Rendered/PDF/multi0page.pdf (last visited Mar. 6, 2010).

[155] The TÜSİAD was found by twelve leading industrialists on April 2, 1971. Its goal was to promote the interest of big business against the small entrepreneurs. *See*, ROBERTH BIANCHI, INTEREST GROUPS AND POLITICAL DEVELOPMENT IN TURKEY 261 (1984). The TÜSİAD is a member of the Business and Industry Advisory Committee (BIAC) to the OECD. *See*, BIAC Membership, http://www.biac.org/members.htm#members (last visited Mar. 6, 2010).

[156] *See* Okyar, *supra* note 148, at 541; Arat, *supra* note 57, at 141.

[157] *See* Okyar, *supra* note 148, at 541.

[158] Krueger, *supra* note 96, at 352.

[159] For the policy objectives of the program and basic structural changes which this program sought to make, *see*, World Bank, Report And Recommendation Of The International Bank For Reconstruction And Development To The Executive Directors On A Structural Adjustment Loan To The Turkey (Feb. 29, 1980) (hereinafter World Bank Report of 1980), *available* at, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/09/02/000178830_98101902343834/Rendered/PDF/multi0page.pdf (last visited Mar. 6, 2010).

[160] *See* Öniş & Şenses, *Major Policy Shifts*, *supra* note 22, at 18.

[161] *See* World Bank Supplement Report of 1980, *supra* note 154, at 9.

[162] Krueger, *supra* note 96, at 352.

Washington to discuss the IMF with the outlines of a new stabilization program and a new stand-by agreement.[163] After Ozal returned from Washington, he worked with his small team to prepare the reform program. The main policies of the program closely resembled those proposed by the TÜSİAD.[164] The TÜSİAD had advocated the modification of economic policies in a liberal and outward-oriented direction. Members of the TÜSİAD had contact with the IMF, the World Bank, the U.S. administration, and members of the American private banking community. The results of these contacts were recorded in a confidential report in 1979.[165] This report called for a neo-liberal economy policy. When the TÜSİAD report was written, Ozal who had previously expressed the same view, was the employee of one of the TÜSİAD's members.[166] Political will was lacking at the national level in the beginning of the neo-liberal reform program: "Even key ministers had been unaware of the scope of the plan outside their own domain, they were asked to sign a variety of decrees on a piecemeal basis and had no advance information as to what other components of the program would be."[167]

One of the major policy objectives of the January 1980 program was to increase domestic resource mobilization efforts.[168] The government announced its intention to augment domestic resource mobilization through changes in tax laws.[169] To accomplish this policy objective, as a structural change, the government was determined to generate future revenues using major tax efforts; including improved tax

[163] *See* Okyar, *supra* note 148, at 542.

[164] Anna O. Krueger and Ilter Turan, *The Politics and Economics of Turkish Policy Reform in the 1980s*, in POLITICAL AND ECONOMIC INTERACTIONS IN ECONOMIC POLICY REFORM: EVIDENCE FROM EIGHTS COUNTRIES 347 (ed. Robert H. Bates and Anna O. Krueger, 1993).

[165] *Id.*

[166] TÜSİAD had explained and expounded on its view of the development of a comprehensive reform package during the 1970s. One of the TÜSİAD publications which was released early in 1978 had contained an article by Ozal suggesting the adoption of freely determined exchange rates. *See*, *id.* at 361.

[167] Krueger, s*upra* note 96, at 351.

[168] The term "domestic resource mobilization" refers to the mobilization of domestic resources in order to develop. It is one of the two sources with external sources for mobilizing development. Domestic sources stem from households which generate savings; firms which generate profits and net earnings; and governments which generate taxes and other public revenues. *See*, Roy Culpeper and Aniket Bhushan, *Domestic Resource Mobilization: A Neglected Factor In Development Strategy* (2008), available at http://www.nsi-ins.ca/english/pdf/NSI%20Background%20paper%20DRM%20SSA%20project%20[2008%20].pdf (last visited Mar. 5, 2010).

[169] World Bank Report of 1980, *supra* note 154, at 10.

administration and the restructuring and rationalization of the tax system.[170] The government also took further steps to foster this structural change, such as improving income distribution for the benefit of low-income groups by restructuring the tax rates, increasing the level of exemptions, increasing public revenues by closing loopholes which allow evasion, and eliminating the effects of inflationary erosion of lump-sum taxes.[171] The overall goal of the tax reform was to increase government revenues and close the fiscal deficit, not to create a more equitable tax system.[172]

However, the Demirel coalition government had difficulties implementing the new liberal policies. Two tax reform bills were presented to the parliament.[173] The major reform proposal of the first bill was to restructure the income tax schedule to reflect recent inflation, and to exempt those earning the statutory minimum wage or less from income tax on equity grounds; the tax reform would also reduce or eliminate taxes on profits from exporting.[174] The second tax reform bill replaced certain production taxes with a VAT and was expected to generate additional net revenue.[175] Due to opposition and the deadlock in parliament, neither proposals were approved in the summer of 1980.[176] The military seized power for the second time in September of 1980.[177] The military NSC banned Suleyman Demirel from active political life for ten years. The team that had been in contact with the IMF staff prior to the coup continued to hold their respective positions.[178] Ozal, as the principal architect of the recent economic policy reforms, was appointed as Minister of State and assistant to the Prime Minister for economic affairs.[179] Kaya Erdem who had worked on the preparation of the stabilization program, was made the Minister of Finance.[180] The military government decided to pursue the January 1980 reform program.[181] They implemented structural adjustments as well as economic policies and

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170 *Id.* at 15.
171 *Id.*, at 42.
172 Krueger, *supra* note 96, at 365.
173 World Bank Supplement Report of 1980, *supra* note 154, at. 12.
174 *Id.* at 13.
175 *Id.*
176 Kruger, *supra* note 96, at 352.
177 *Id.*
178 Kruger, *supra* note 96, at 352.
179 Krueger & Turan, *supra* note 164, at 362.
180 *Id.*
181 World Bank Supplement Report of 1980, *supra* note 154, at 9.

commitments agreed upon with the World Bank, IMF, and members of the OECD Consortium for Turkey.[182] One of the first steps the NSC's civilian cabinet took was to adopt the tax reform stipulated by the January 1980 program.

The government bureaucrats were the driving force behind this decision, and they persuaded the military authority to adopt the reforms.[183] A minister, who served in the first cabinet established by the military leadership in September 1980, confirmed this persuasive effort:

> The Demirel government had been able to enact none of the tax laws which had been foreseen in the economic stabilization program. . .[X] explained the generals that the legislation of new tax laws was absolutely necessary in order to go on with the stabilization program and to balance the oncoming budget. They listened carefully. They accepted. They were reasonable men. [184]

Even the government bureaucrats were internal actors in the 1980 tax reforms, however it was the external actors that played a key role in the reforms. Just two days after the 1980 coup, the IFIs were officially informed of the military government's decision to pursue the program of structural adjustment announced in January 1980, as well as the economic policies and commitments agreed with them.[185] The TÜSİAD, which shared the same economic policy view as the external actors, were very effective in political life. Both before and after the coup there were good relations between top military leaders and the major corporations in Turkey.[186] These major corporations employed retiring generals on their boards of directors.[187] The Constitution of 1982 featured a much less participant-based and pluralistic version of democracy than

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[182] *Id*.

[183] "In the early 1980s, the military government introduced a plethora of tax changes that depended for the most part on the ability of government bureaucrats to gain access to the inner power circle and *persuade* the military authorities to adopt their ideas." *See*, Bulutoğlu & Thirsk, *supra* note 38, at 367.

[184] Interview with a minister who served in the first cabinet established by the military leadership in September 1980, Krueger & Turan, *supra* note164, at 361.

[185] World Bank Supplement Report of 1980, *supra* note 154, at 9.

[186] Krueger & Turan, *supra* note 164, at 347.

[187] *Id.* at 362.

the version envisioned in the previous 1961 Constitution.[188] NSC rule brought about important changes in the legal status of the interest groups, consisting of associations,[189] foundations,[190] public professional organizations,[191] trade unions, and employers' associations.[192] Interest groups were banned from political activities which meant they were unable to pursue political aims, engage in political activities, receive support from or give support to political parties, and take action with trade unions, public professional organizations, or foundations.[193] The real aim of these measures was to restrict the demands of the masses. As

[188] *See*, Ergun Ozbudun, *The Post-1980 Legal Framework for Interest Group Associations*, in STRONG STATE AND ECONOMIC INTEREST GROUPS: THE POST-1980 TURKISH EXPERIENCE, 41-53 (Metin Heper ed., 1991).

[189] An association (or a society) is formed by a group of persons who unite their knowledge and activities continuously for a non-profit-sharing purpose. *See*, Tugrul Ansay, *Legal Persons, Societies and Business Associations*, in INTRODUCTION TO TURKISH LAW 100 (Tugrul Ansay & Don Wallace Jr. eds., 2005).

[190] A foundation is a non-profit institution formed by the allocation of a fund or property for a specified purpose. *See*, *id.*, at 99.

[191] A public professional organization is a public corporate body, established by law, with the objectives to meet the common needs of the members of a given profession, to faciliate their professional activities, to ensure the development of the profession in keeping with common interests, and to safeguard professional discipline and ethics in order to ensure integrity and trust in relations among their members and with the public. *See*, Sait Guran, *Administartive Law*, in INTRODUCTION TO TURKISH LAW 66 (Tugrul Ansay & Don Wallace Jr. eds., 2005).

[192] Both trade unions and employers' associations are interest groups formed to protect and promote the economic and social rights and interests of their members in industrial relations. *See*, Ozbudun, *supra* note 188, at 49.

[193] 1982 Türkiye Cumhuriyeti Anayasası (Turkish Constitution of 1982) (hereinafter 1982 AY) (RG: November 9, 1982/ 17863bis.), Art. 33/4, 52/1, 135/3. In 2001 amendment, these forbiddances were reversed. *See*, 4709 sayılı Türkiye Cumhuriyeti Anayasasının Bazı Maddelerinin Değiştirilmesi Hakkında Kanun (Act of 4709 on Amendment of Some Articles of Turkish Republic Constitution) (RG: October 17, 2001/24556bis.), *available* at http://www.tbmm.gov.tr/kanunlar/k4709.html (last visited Sep. 1, 2011). The current text of 1982 AY is available in English at http://www.byegm.gov.tr/content.aspx?s=tcotrot (last visited in Sep. 1, 2011). The legal status of interest groups associations is very important for our later appraisal of public participation in tax lawmaking procedure. I should add that there has been a discussion in Turkey for a new constitution which attempts to include more participation. *See*, ZUHTU ARSLAN, TURKEY'S BID FOR THE NEW CONSTITUTION, SETA FOUNDATION FOR POLITICAL, ECONOMIC AND SOCIAL RESEARCH POLICY BRIEF NO. 1 (2007), *available* at http://www.setav.org/public/HaberDetay.aspx?Dil=tr&hid=7166&q=turkey-s-bid-for-the-new-constitution (last visited Sep. 1, 2011) (analyzing the basic parameters of the new draft constitution in Turkey). Turkey's civil society organizations, including powerful businessmen's groups the TÜSİAD and the Turkish Union of Chambers and Commodity Exchanges (TOBB), have voiced their demand for a new constitution many times. *See*, *TOBB Baskani Hisarciklioglu: Yeni Anayasa Sart*, Referans Gazetesi, February 4, 2010, *available* at http://www.referansgazetesi.com.xn--ler-1la8h.net/haber.aspx?HBR_KOD=136387; *TÜSİAD: Oncelikli Konu Anayasa Reformudur*, Milliyet Gazetesi, February 15, 2010, available at http://www.milliyet.com.tr/tusiad-oncelikli-konu-anayasa-reformudur/ekonomi/sondakika/15.02.2010/1199346/default.htm (last visited Sep. 1, 2011).

a result, the new measures were applied more strictly to trade unions than to business associations.[194] In spite of the fact that the 1982 Constitution prohibited associations from engaging in politics, the TÜSİAD was able to actively maintain its involvement in politics.[195]

When the military government started to implement the January 1980 program, one of the very first steps they undertook was the tax reform of 1980. By Ozal's account, the program policy targets- which included tax reform- were achieved because of military administration:

> If the intervention of September 12 had not been conducted, we would not have been able to obtain the results of the economic program. Anarchy was on the rise and the tax laws did not go through the National Assembly. We should be thankful that a tax reform has been conductedFalse[196]

The NSC did not undertake all the necessary steps of the 1980 tax reform. According to a retired high ranking bureaucrat from the Ministry of Finance:

> Nobody should credit the generals for doing everything required of the stabilization program. They enacted only one-fourth of the tax proposals into law. About the others, they said 'Elected governments can take care of them when we go. . . .[197]

Some scholars have interpreted this to mean that the military authorities probably refrained from making decisions and adopting policies which would undermine their popularity.[198]

The VAT was one of the tax reforms not enacted by the military government. The VAT system had been recommended to Turkey by several tax experts; notably, Carl S. Shoup from the United Nations and Leif Muten from the IMF.[199] It was not until 1983, after the military organized general elections, that VAT was enacted by the elected

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194 Arat, *supra* note 57, at 144.
195 *Id.*
196 Krueger & Turan, *supra* note 164, at 363.
197 *Id.*
198 *Id.*, at 362.
199 *See*, Varcan, *supra* note 21, at 115, 117.

government, under the Motherland Party, which was founded by Ozal in 1983. Yet, although the duly-elected Ozal government enacted the VAT, the VAT was still perceived as a product of a "guided democracy"[200] because the post-1983 parliament banned a number of political parties from participating in the 1983 election.

Turkey was widely praised as an example of a successful transition from an inward to an outward development strategy by the IFIs.[201] Inflation decreased from three digit levels in 1980 to 30 percent in 1981 and 1982.[202] During the 1981-1982 periods, the current account deficit was cut in half.[203] The public sector borrowing requirement dropped down from around 10 percent of the GNP[204] to less than 4 percent.[205] The first phase of Turkish neo-liberalism ended at the end of the 1980s with the decision to completely open up the capital account.[206]

D. THE NEW PHASE OF NEO-LIBERALISM

The second phase of Turkish neo-liberalism, which was not as successful as the first, came into being in the 1990s.[207] An unstable economy suffered from chronic fiscal deficits, high inflation, and a succession of weak coaltition governments.[208] Major economic crises occurred in April 1994, November 2000, February 2001.[209] The first

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[200] Fikret Senses, Turkey's Stabilization and Structural Adjustment Program in Retrospect and Prospect, 23 (3) THE DEVELOPING ECONOMIES 214 (l991), available at http://onlinelibrary.wiley.com/doi/10.1111/j.1746-1049.1991.tb00208.x/pdf.

[201] Yılmaz Akyüz & Korkut Boratav, *The Making of the Turkish Financial Crisis*, United Nations Conference on Trade and Development Discussion Paper No. 158 (2002), *available* at http://www.econturk.org/Turkisheconomy/boratav.pdf (last visited Feb. 23, 2010); ZÜLKÜF AYDIN, THE POLITICAL ECONOMY OF TURKEY 48 (2005). For a detailed analysis of Turkish neo-liberalism in the 1980s, *see*, THE POLITICAL ECONOMY OF TURKEY (Tosun Aricanli & Dani Rodrik eds., 1990).

[202] Akyüz & Boratav, *supra* note 201, at 3.

[203] *Id*.

[204] GNP is the total market value of goods and services produced by all citizens of a country in a year.

[205] Akyüz & Boratav, *supra* note 201, at 3.

[206] *See*, Ziya Öniş & Fikret Şenses, *The New Phase of Neo-Liberal Restructuring in Turkey: An Overview*, in TURKEY AND THE GLOBAL ECONOMY: NEO-LIBERAL RESTRUCTURING AND INTEGRATION IN THE POST-CRISIS ERA 1 (Ziya Öniş & Fikret Şenses eds., 2009) (hereinafter Öniş & Şenses, *Neo-Liberal Restructuring*).

[207] *Id.*

[208] *Id.*

[209] The several countries that adopted laissez-faire economics also encountered economic crises during the 1990s, such as Argentina (1995, 2001), Brazil (1999), Mexico (1994/1995), Russia (1998), and the countries of South East Asia (1997). *See*, Fırat Demir, *Turkish Post-Crisis*

economic crisis was not strong enough for a political shift. Continuing bad economic conditions led the government to sign a stand-by agreement with the IMF in December of 1999.[210] While in 1990 32 percent of national tax revenues were spent on servicing the public debt, in 1999 that number increased to 72 percent.[211] Thus, the three-party coalition government led by Bülent Ecevit, who was chosen to serve as prime minister, suffered from a lack of resources for education, health, and other basic activities. The IMF's support of Turkey was also related to Turkey's geo-political position of the country.[212] After the Cold War Turkey still remained a key ally of the United States in the Middle East and Caspian region.[213]

Turkey transtioned into a new era of neo-liberalism after the last economic crisis in 2001.[214] After the crisis, Kemal Dervis, who had been a senior official at the World Bank, became the Minister of Economy.[215] In this capacity, Dervis secured a vital sixteen billion US dollar package of IMF loans and embarked on an ambitious, and often painful, economic recovery program.[216] When Dervis submitted a Letter of Intent

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Development Experience From A Comparative Perspective: Structural Break or Business As Usual?, in TURKEY AND THE GLOBAL ECONOMY: NEO-LIBERAL RESTRUCTURING AND INTEGRATION IN THE POST-CRISIS ERA, 11 (Ziya Öniş & Fikret Şenses eds., 2009).

210 The Letter of Intent (December 9, 1999), *available* at http://www.imf.org/external/np/loi/1999/120999.htm (last visited Feb. 26, 2010).

211 STRENGTHENING THE TURKISH ECONOMY: TURKEY'S TRANSITION PROGRAM (April 14, 2000), *available* at http://www.tcmb.gov.tr/yeni/announce/strengteningecon.pdf (last visited Feb. 26, 2010).

212 *See*, Öniş & Şenses, *Neo-Liberal Restructuring*, *supra* note 209, at 3. A comparison with Argentina shows that the IFIs consider not only economy but also politic interest of the member de facto the U.S. The IMF had supported Argentina during the Cold War, but the political importance of the country declined in the post Cold War era. The IMF reversed its course in late 2001 and refused Argentina's request for a loan waiver, causing the country to go into default and financial collapse in December 2001. Even they had similar crises, Turkey was bailed out; Argentina was not. *See*, Ümit Cizre & Erinç Yeldan, *The Turkish Encounter With Neo-Liberalism: Economics and Politics in the 2000/2001 Crises*, 12:3 REV. INT. POLIT. ECONOMY 403 (2005).

213 *See*, Lerna K. Yanık, *Beyond 'Bridges', 'Crossroads' and 'Buffer Zones': Defining a New International Role for Turkey*, *available* at http://www.brookings.edu/comm/events/20060523sabanci_1.pdf (last visited Feb. 23, 2010) (decribing the U.S.-Turkish relations in the post-9/11 era).

214 Keyman & Öniş, *supra* note 80, at 143. Keyman and Öniş define this new development phase as "the development of regulatory capacities of the state which involves not only the setting up of the new institutions but also a significant increase in their powers of implementation."

215 BBC News, *Profile: Kemal Dervis* (August 12, 2002), *available* at http://news.bbc.co.uk/2/hi/europe/2184663.stm (last visited Sep. 1, 2011).

216 *Id.*

(LOI)[217] in May 2001 to the IMF, he announced the "Program for Transition to the Strong Economy" aimed at transforming "the old ways of economic policy making."[218] With Dervis serving as the Minister of Economy, Turkey put in place a medium-term tax reform strategy based on a review carried out jointly with the World Bank in 2001.[219] All the

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[217] The respective countries prepare different types of policy intentions documents for the purpose of setting forth policy intentions in respect to use of the IMF resources or staff-monitored programs. The LOI is a document in which a member country of the IMF formally requests an arrangement to use the Fund's financial resources and describes its commitments to strengthen its economic and financial policies. It may be accompanied by a more detailed Memorandum of Economic and Financial Policies (MEFP) or Technical Memorandum of Understanding (TMU). *See*, IMF, GLOSSARY OF SELECTED FINANCIAL TERMS, *available* at http://www.imf.org/external/np/exr/glossary/showTerm.asp#104; http://www.imf.org/external/np/cpid/default.aspx?dType=Letters+of+Intent+-+Memoranda+of+Economic+Policies. The member countries may prepare the Poverty Reduction Strategy Paper (formerly the Policy Framework Paper) in collaboration with the staffs of the IMF and World Bank as well as civil society and development partners. They describe the authorities' economic objectives, macroeconomic and structural policies for there-year economic adjustment programs supported by the Poverty Reduction and Growth Facility to foster growth and reduce poverty, and associated external financing needs and major sources of financing. *See*, http://www.imf.org/external/np/cpid/default.aspx?dType=Policy+Framework+Papers;http://www.imf.org/external/np/cpid/default.aspx?dType=Poverty+Reduction+Strategy+Papers. All these documents dated after 1997 are being made available on the IMF website by agreement with the member country as a service to users of the IMF website. *See*, http://www.imf.org/external/np/cpid/default.aspx. Turkey has had 23 LOIs since 1997 accompanied by 4 MEFP and 2 TMUs. *See*, http://www.imf.org/external/np/cpid/default.aspx?gType=CPID&selCountry=Turkey&DType=Letters+of+Intent+-+Memoranda+of+Economic+Policies&selLang=Select+Language&selMonth=Month&selYear=Year&selMonth1=Month&selYear1=Year&submitx.x=26&submitx.y=11. The IMF also may expect adoption of some corrective measures before a stand-by arrangement is approved. If the corrective measures are taken before Executive Board approval, they are called "prior actions". If the corrective measures are carried out after the board approval, but before drawing on the arrangement, they are called "preconditions". During the 1980s, the requirement of prior actions became common, especially in the form of exchange rate devaluations or other actions meant to correct for an earlier loss of international competitiveness. Tax reforms and adjustments to administered prices also were frequent candidates for prior action, especially during the 1980s. *See*, JAMES M. BOUGHTON, SILENT REVOLUTION THE INTERNATIONAL MONETARY FUND 1979-1989, 605 and footnote 120 (2001), *available* at http://www.imf.org/external/pubs/ft/history/2001/ch13.pdf (last visited Feb. 10, 2010).

[218] See, Arpaç & Bird, *supra* note 21, at 142; Erinc Yeldan, On the IMF-Directed Disinflation Program in Turkey: A Program for Stabilization and Austerity or a Recipe for Impoverishment and Financial Chaos, in THE RAVAGES OF NEO-LIBERALISM: ECONOMY, SOCIETY AND GENDER IN TURKEY 2 (Nesecan Balkan & Sungur Savran eds., 2002).

[219] The strategy had three main elements: rationalization of indirect taxation by replacing several taxes by one tax (Special Consumption Tax); rationalization of personal and corporate income taxes; reorganization of the tax administration. *See*, OECD, TAX POLICY REFORMS IN TURKEY, http://www.oecd.org/dataoecd/49/24/37154710.pdf.

elements of this strategy were implemented despite a change in governing parties in the 2002.[220]

The 2002 elections established the Adalet ve Kalkınma Partisi (Justice and Development Party) (AKP) as the predominant political Party. The AKP declared they would continue to implement the IMF stand-by program.[221] The AKP defeated all other established parties and became the ruling party, marking the first non-coalition government since 1991.[222] The Chairman of the AKP announced the year-long Urgent Action Plan in a press conference on November 16, 2002.[223] The AKP government initiated the Urgent Action Plan to remedy long-lasting economic problems and improve social and economic welfare in the country.[224]

One of the basic components of this plan was tax reform.[225] The AKP government's first step towards tax reform was to abandon the legislation, publicly known as the Financial Millennium Law, established by Law no. 4369.[226] According to the Financial Millennium Law, people could deposit their unregistered cash and valuable riches without having anyone question its sources on a day called the "financial millennium."[227] Thus, the Financial Millennium Law intended to take the Turkey's unregistered-economy into the legal system.[228] Furthermore, it changed the notion of "income."[229] The net accretion theory took the place of source theory.[230] Law no. 4369 was never implemented, and was

[220] Keyman & Öniş, *supra* note 80, at 146, 149.
[221] *Id.*, at 151.
[222] *Id.*, at 149.
[223] *See*, The Account of Recep Tayyip Erdogan, Acil Eylem Plani (November 16, 2002) (herein after Acil Eylam Planı), available at http://www.belgenet.com/eko/acileylem_161102.html (last visited Mar. 5, 2010).
[224] CENGIZ KAHRAMAN, FUZZY MULTI-CRITERIA DECISION-MAKING: THEORY AND APPLICATIONS 89 (2008).
[225] "As soon as our Government is set sup, a comprehensive tax reform study will be start. In this context, Financial Millennium will be invalidate in the first month. Within the next three months: some measures accordance with the allocation of tax burden by broadening tax base will be taken, the tax legislation will be simplified, the tax peace plan will be implemented", *see*, Acil Eylem Planı, *supra* note 223.
[226] *See*, 4369 sayili Kanun (the Law of 4369) (RG: July 29, 1998; 23417).
[227] Oecd Economıc Surveys: Turkey 68 (1999) available at: http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-turkey-1999_eco_surveys-tur-1999-en.
[228] Also an important improvement bringing in 4369 was to present it to the public to discuss after the draft was prepared. This was an apposite change to the democratic taxation.
[229] 4369 sayılı Kanun, *supra* note 226, Art. 24.
[230] There are two categories of income tax theories: source and net accretion. Source theories only cover the income from the source, not the source itself, that is to exclude capital gains and losses.

eventually abolished by Law no. 4783.[231] Article 30/7 of the Tax Procedure Law, which gave tracing of property and expenses authority to tax auditors, was abolished at the same time.[232]

The Tax Peace Law, commonly referred to as the "Tax Peace Plan," was the second step of recent tax reforms the AKP accepted. The Tax peace plan was enacted by the Assembly on February 25, 2003.[233] The aim of this amnesty law was to resolve tax controversies by restructuring accrued and uncollected taxes owed by taxpayers affected by the 2001 economic crisis. The AKP government later implemented the World Bank-supported medium-term tax reform strategy of 2002. The AKP government announced the tax changes as a competitiveness consideration consistent with the developments and the trends in the European Union and OECD countries.[234]

One of the fulfillments of the medium-term tax reform strategy was reorganization of the tax administration.[235] To accomplish this goal, the AKP government used a report prepared by the TÜSİAD and the Tax Council.[236] When the report is examined closely, the role of external tax experts can be seen. Tax administration officials from developed

Net accretion theories seize the net accretion of one's economic power between two points of time, STEFANO SIMONTACCHI, TAXATION OF CAPITAL GAINS UNDER THE OECD MODEL CONVENTION 122 (2007).

231 *See*, 4783 sayili Gelir Vergisi Kanunu, Vergi Usul Kanunu, Kurumlar Vergisi Kanunu, Veraset ve Intikal Vergisi Kanunu, 4306 sayili Kanun, 4481 sayili Kanun ve 4562 sayili Kanunda Degisiklik Yapilmasi Hakkinda Kanun (The Law of 4783 Amending the Income Tax Law, the Tax Procedure Law, the Corporate Income Tax Law, the Inheritance and Succession Law, Law 4306, Law 4481 and Law 4562) (RG: January 9, 2003; 24988), *available* at http://www.tbmm.gov.tr/kanunlar/k4783.html (last visited Sep. 1, 2011).

232 *Id.* Art. 9.

233 4811 sayili Vergi Barışı Kanunu (Law of 4811 on Tax Peace) (RG: February 27, 2003; 25033), *available* at http://www.tbmm.gov.tr/kanunlar/k4811.html (last visited Sep. 1, 2011).

234 The Republic of Turkey, Screening Chapter 17: Economic and Monetary Policy 19 (2006), *available* at http://www.abgs.gov.tr/tarama/tarama_files/17/SC17DET_Fiscal%20Policy.pdf (last visited Sep. 1, 2011).

235 There were several reports about tax administration reform. Some of them are written by tax experts from the U.S. tax administration, IMF, and OECD (James W. Martin and Frank C.E. Chus (1951), B. Frank White (1963), Daniel L. Tucker (1970), Leif Muten (1972), Socorro Velazquez (1999)), *see*, İlhan Karayilan & Doğan Alantar, Gelir İdaresinin Yeniden *Yapılandırılması*, 127 Yaklasim Dergisi 71-77 (2003).

236 An official of the Presidency of Revenue Administration (GIB) stated that this report became the base of their work on reorganization of the tax administration (interview with GIB official in Ankara, Turkey, July 23, 2009) (notes on file with author). *See*, TÜSIAD -VERGI KONSEYI RAPORU, TURK GELIR IDARESININ YENIDEN YAPILANDIRILMASI: TEMEL TASARIM (2003), *available* at, http://www.vergikonseyi.org.tr/dosCalismalar/rapor10.pdf (last visited Sep. 1, 2011).

countries and academics were counted as contributors in the report.[237] As a matter of fact, tax administration reform had been on the agenda of Turkish governments since Turkey and the World Bank had a loan agreement for a "Public Financial Management Project" (PFMP) from 1995 to 2002.[238] One feature of the PFMP was a plan for the "reconstruction" of the Turkish tax administration. The details of reconstruction are unclear from the available PFMP documentation. However, a report describing the completion of the PFMP stated that Turkey had completed an organizational study under a consultation contract with the U.S. Internal Revenue Service, and had engaged in an extended dialogue with the IMF regarding organization and other matters related to tax administration.[239] The completion report further stated that Turkey had implemented only a few of the U.S. and IMF recommendations, and the report implied that more reforms should have been implemented.[240] Within one month of the report's release, the Turkish Grand National Assembly (TBMM) had adopted many of the report's proposed reforms to the tax codes, including a new guidance mechanism in 2003.[241]

[237] Larry G. Westfall from IRS and U.S. Treasury; Astrid Boel and Inge-Marie Christoffersen from Denmark Customs and Tax Administration; Mary Dwyer, Brian Boyle, and Christopher Clayton from Irish Revenue Commissioners; Australian Tax Office (not mentioned an official's name); Glenn Jenkins, Harvard University; Michael Goold, Ashridge Strategic Management Center. *Id.* at 12.

[238] Loan Agreement (Public Financial Management Project) between the Republic of Turkey and International Bank for Reconstruction and Development, Dated October 11, 1985, *available at*, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/ECA/2004/12/15/C7CF71FAC798FA4285256F03000CA235/1_0/Rendered/PDF/C7CF71FAC798FA4285256F03000CA235.pdf

[239] *See*, Implementation Completion Report on a Loan In the Amount of US$62 Million to the Republic of Turkey for a Public Finance Management Project 6 (June 6, 2006) (hereinafter Implementation Completion Report), *available at*, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2003/06/27/000090341_20030627140004/Rendered/PDF/25572.pdf (last visited Feb. 15, 2010).

[240] *See*, *id*., at 8-9.

[241] Act No. 4962 (RG: August 07, 2003/ 25192), Art. 17, *available* at http://www.tbmm.gov.tr/kanunlar/k4962.html (last visited Sep. 1, 2011). It revised 213 VUK § 413 (2) to allow the tax authority to answer written ruling demands either in writing or in the form of a revenue ruling.

IV. A NEW TRAJECTORY FOR TAX REFORM ASSESSMENT: FROM EFFICIENCY TO LEGITIMACY

The preceding two parts of this paper have shown Turkey's experiences with tax reform. In the tradition of classical approaches to empirical studies on tax reform, the next step is to examine the tax reform to learn lessons for improving future attempts at reform.[242] This approach focuses on the outcome of the past reforms and asks whether or not they can be considered a success. This means that each country's implementation procedure is evaluated according to the effectiveness of its tax reform.[243]

Academics generally accept that evaluating the performance of the IFI-supported program is difficult because of the variety of effective factors.[244] Determining the success and failure of tax reform is specifically complicated by the lack of widely accepted metrics. The label "successful" might be reserved for those reform proposals, projects, or packages that were in large measure enacted into law.[245] However, this metric by itself fails in two respects. First, tax reforms that become

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[242] *See, e.g.*, TAX REFORM IN DEVELOPING COUNTRIES (Malcolm Gillis ed., 1989); TAX REFORM IN DEVELOPING COUNTRIES (Wayne Thirsk ed., 1997) [hereinafter Tax Reform (Thirsk)]; WORLD TAX REFORM: CASE STUDIES OF DEVELOPED AND DEVELOPING COUNTRIES (Michael J. Boskin & Charles E. McLure, Jr. eds., 1990).

[243] *See, e.g.*, TONY KILLICK, IMF PROGRAMS IN DEVELOPING COUNTRIES: DESIGN AND IMPACT (1995); PATRICK CONWAY, EVALUATING FUND PROGRAMS: METHODOLOY AND EMPRICAL ESTIMATES (1998); Nadeem Ul Haque & Mohsin S. Khan, *Do IMF-Supported Programs Work? A Survey of the Cross-Country Empirical Evidence*, a Working Paper of the International Monetary Fund (1998) (http://www.imf.org/external/pubs/ft/wp/wp98169.pdf); Graham Bird, *The Implementation of IMF Programmes: A Conceptual Framework*, 3 REV. INT. ORG. 41-64 (2008). For a study on the effectiveness of IMF program in Turkey, *see*, Arpaç & Bird, *supra* note 21.

[244] There have been five most frequently used methods in the empirical literature on IMF programs. These are before-after, with-without, regression based evaluations, target-outcome comparisons, and comparison of simulations. These methods respectively compare the initial situation and the current situation of the program countries; a sample of program countries and a control group of non-program countries; performance in program and non-program countries, controlling for outside factors; actual outcomes with targets that are written into IMF program; and hypothetical program and simulated results. *See*, Ozlem Arpaç, THE IMPLEMENTATION OF IMF-SUPPORTED PROGRAMMES : AN EMPIRICAL INVESTIGATING USING COMPLEMENTARY METHODOLOGIES 7-21 (2007) (unpublished Ph.D. thesis), *available* at http://epubs.surrey.ac.uk/626/1/fulltext.pdf.

[245] Malcolm Gillis, *Tax Reform: Lessons from Postwar Experience in Developing Nations*, in TAX REFORM IN DEVELOPING COUNTRIES 492 (Malcolm Gillis ed., 1989) (hereinafter Gillis, *Lessons*). Timing also might be considered while defining the success. Tax Code Project 1953 in Brazil was partly embodied in the National Tax Code of 1966. After 12 years, could it be regarded as successful because it became legislation?

legislation might fail to fulfill the adopting government's objectives, and so cannot qualify as successful. This is a chronic problem of law-on-the-books versus law-in-practice in the tax reform area. Second, comparative research has demonstrated that tax reforms which were never enacted may still be regarded as successful because they forever changed the national agenda for tax policy discussion.[246]

Tax reform objectives have been used in literature to assess the success of tax reform. The main objectives of tax reform are "revenue," "redistribution," "promotion of economic growth," "simplification," and "improved resource allocation."[247] Often, these results are measured using quantitative measures, especially the ratio of tax to GDP, i.e. tax ratio. The tax ratio has been seen as self-evident proof of the need for tax reform for a long time, [248] so that a rising tax ratio has also been accepted as a goal in Turkish tax reform. Since 1965, the total Turkish tax revenue as a percentage of the GDP has increased to around 13.7 percent.[249] As of 2007, the ratio stood at 23.7 percent; Turkey's ratio is relatively low compared with an average tax ratio of 35.8 percent for the OECD and 38.8 percent for the EU19.[250] On the other hand, the Turkey's tax ratio is lower than the United States' tax ratio, which was 28.3 percent in 2007.[251] Turkey's tax-to-GDP ratio is also higher than a lot of developing countries. The tax-to-GDP ratio is around 18 percent in Sub Saharan Africa, 18.5 percent in Latin America and the Caribbean (Brazil has the highest ratio at more than 34 percent), and between 14 and 18 percent in most Asian countries, except for South Korea and Japan.[252]

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[246] Such as Even Carter Commission 1966 proposal in Canada and Musgrave Commission 1968. *See*, *id.*

[247] *Id.* at 493.

[248] Stewart, *Global Trajectories*, supra note 3, at 174.

[249] 1965 (10.6), 1966 (10.7), 1967 (11.4), 1968 (11.3), 1969 (12.4), 1970 (9.3), 1971 (10.7), 1972 (10.8), 1973 (11.3), 1974 (10.5), 1975 (11.9), 1976 (12.1), 1977 (12.7), 1978 (12.4), 1979 (11.7), 1980 (13.3), 1981 (14.1), 1982 (13.7), 1983 (12.8), 1984 (10.7), 1985 (11.5), 1986 (13.0), 1987 (14.0), 1988 (13.2), 1989 (13.9), 1990 (14.9), 1991 (15.6), 1992 (16.7), 1993 (16.9), 1994 (16.5), 1995 (16.8), 1996 (18.9), 1997 (20.7), 1998 (20.1), 1999 (23.1), 2000 (24.2), 2001 (26.1), 2002 (24.6), 2003 (25.9), 2004 (24.1), 2005 (24.3), 2006 (24.5), 2007 (23.7), 2008 provisional (23.5). *See*, OECD, REVENUE STATISTICS 1965-2008, 76-78 (2009).

[250] EU19 area countries are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom, Czech Republic, Hungary, Poland and Slovak Republic. *See, id.*

[251] *Id.*

[252] *See* European Union, *Fact Sheet "Tax Development"* (2009), *available* at http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/545&format=HTML&aged=0&language=EN&guiLanguage=en.

According to the revenue objective, Turkish tax reform became successful by raising the tax ratio.[253] However, the tax ratio measure fails in several ways, such as including the non-monetary economy, for example, women's and rural community work; accounting for non-tax sources of public funding as ownership of state enterprises or natural sources; and accounting for the operation of quasi-fiscal activities and regulations.[254] More importantly, the tax ratio measure does not tell us which groups of taxpayers were burdened by rising taxes and whether they consented to the increase in their tax burden.

In terms of legitimacy, much of the tax reforms encouraged by extrinsic actors took shape in Turkey outside of democratic institutions and processes. Turkey's history with tax reform suggests the suppliers of tax reform were fully instrumentalist, outcome-oriented, and unconcerned with the means of implementing the desired reforms. Several tax reforms in Turkey were enacted under the rule of an authoritarian government.[255] One of the most significant tax reforms, the VAT, was enacted under a guided democracy.[256] These experiences were in accordance with the widespread assumption that major economic liberalization reform projects, as well as tax reforms, were more successful in authoritarian states.[257] During all these tax reforms, the IGOs continued to support the tax reform efforts of authoritarian or undemocratic governments.

However, democracy and legitimacy exists together in liberal democracies,[258] therefore it is clear that the IGOs did not seek legitimacy. Even though external actors were involved in the tax reform efforts following the 2001 crisis, these efforts occurred without military

[253] In the aspect of revenue implications, Gillis marked developing country tax reform with success. The typical share of GDP hovered about 11 percent in 1050s, 16 percent in the period 1972-76, and 17.5 percent in the period 1977-81. *See*, Gillis, *Lessons, supra* note 245, at 494.

[254] Stewart, *Global Trajectories*, *supra* note 3, at 174.

[255] *See* Part II, B and C.

[256] *See* Part III, C.

[257] See, e.g., Chantal Thomas, *Does the "Good Governance Policy" of the International Financial Institutions Privilege Markets at the Expense of Democracy?*, 14 CONN. J. INT'L L. 551, 557 (1999); Arnold C. Harberger, *Lessons of Tax Reform the Experiences of Uruguay, Indonesia, and Chile*, in TAX REFORM IN DEVELOPING COUNTRIES 27 (Malcolm Gillis ed., 1989). A study casts doubt upon this assumption see, Karen L. Remmer, *The Politics of Economic Stabilization: IMF Standby Programs in Latin America*, 1954-1984, 19 COMP. POLIT. 1-24 (1986) (showing regime type is far less important than has been supposed).

[258] Jean Blondel, Richard Sinnott & Palle Svensson, PEOPLE AND PARLIAMENT IN THE EUROPEAN UNION: PARTICIPATION, DEMOCRACY, AND LEGITIMACY 4 (1998).

intervention.[259] Moreover, the General Ground[260] of the Corporate Income Tax Act, one of the most important steps of the AKP Government, emphasizes "the draft is being prepared with the understanding and wide participation of society."[261] This demonstrates an emphasis on public consensus. Yet this public participation does not demonstrate a quest for democratic legitimacy in Turkish tax reform. The AKP's new participation effort is just a part of a good governance approach aimed at the agenda of the IGOs in the governance of developing countries. Which begs the question, could participatory processes improve tax governance[262] in developing countries?

International institutions create "one size fits all tax norms." The same prescriptions are offered to all countries despite of these countries' differences in terms of economic and social development and government.[263] In the Turkish tax system, the prominent international tax expert Victor Thuronyi expresses a traditional view of the IGOs and the tax lawmaking process:

> In terms of process, one observation I have is that it would be useful to involve in the drafting process tax lawyers with experience in drafting tax laws. In this

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[259] Nonetheless, a magazine, *Nokta*, and a newspaper, *Taraf*, exposed several unaccomplished coup plans in the code name of Balyoz, Kafes, Sarikiz, Ayisigi, Yakamoz, and Eldiven in 2003 and 2004. It was suggested that the most important reason of failure is the lack of external support for the military intervention. *See 2004'te Iki Darbe Atlatmisiz* [*Two Coups Evaded in 2004*], NOKTA, Mar. 29, 2007 at 22; *Kod Adi Kafes* [*Code Name Lattice*], TARAF (Nov. 19, 2010), *available* at http://taraf.com.tr/haber/44228.htm; *Darbenin Adi Balyoz* [Coup was Named Sledgehammer], TARAF (Jan. 20, 2010), *available at* http://www.taraf.com.tr/haber/46614.htm.

[260] A ground is a technical explanation of government action. There are two kinds of grounds: a general ground (genel gerekçe) and a ground of article (madde gerekçesi). A general ground is a broad explanation of why a draft bill is needed, while a ground of article is a specific explanation for each of the provisions of the draft bill. *See*, YASAMA DERNEĞI [LEGISLATION ASS'N], SIVIL TOPLUM İÇIN YASAMA SÜRECINE KATILIM EL KITABI [PARLIAMENTARY HANDBOOK FOR CIVIL SOCIETY ORGANIZATIONS] 63 (2009), *available* at http://www.yasader.org/web/stk_el_kitabi/son/stk_el_kitabi_tum.pdf.

[261] *See* KURUMLAR VERGISI KANUNU: GENEL GEREKÇE, MADDE GEREKÇELERI [CORPORATE INCOME TAX LAW: GENERAL JUSTIFICATION, JUSTIFICATION OF THE ARTICLES] 1 (2006), *available at* http://www.gib.gov.tr/fileadmin/user_upload/Gerekceler/5520_Sayili_Kanun.pdf.

[262] The term "tax governance" refers to the role of national governments and local authorities in devising and regulating tax systems. The term is also used in a different sense to introduce "corporate governance as it relates to tax." *See* DAVID F. WILLIAMS, DEVELOPING THE CONCEPT OF TAX GOVERNANCE 4 (2007), *available at* http://www.kpmg.co.uk/pubs/Tax%20Governance%20Feb%2007.pdf.

[263] Surendra Munshi & Biju Paul Abraham, *Introduction* to GOOD GOVERNANCE, DEMOCRATIC SOCIETIES AND GLOBALISATION 17 (Surendra Munshi & Biju Paul Abraham eds., 2004).

> context, tax policy officials in Turkey may be interested in the assistance that the IMF Legal Department can offer. We have worked with numerous countries, in modalities appropriate to each country. In some countries, the draft tax law has been prepared by local officials and, where needed, translated into English. Then an expert from the Legal Department (in some cases two experts working together) has travelled to the country to sit down with the responsible officials and go through the draft article by article. This is an intensive process that normally requires one or two weeks of fairly intensive all-day meetings going through the draft. As a result of these discussions, problems are identified, the policy intentions of the authorities are clarified, and a solution for the specific wording of the law is found. This kind of approach can bring in experience and best practices from other countries and has helped local officials to deliver well drafted tax laws for consideration by the government and eventually by Parliament.[264]

The good governance approach merged from IGOs, such as the World Bank, OECD, UN, and Western governments such as Britain, France, and the United States between 1989 and 1992. The West ceased to support anti-communist authoritarian regimes and started to adopt good governance as a condition of their support.[265] Even if good governance has a definition problem, the concept of good governance embodies six core principles. These are: (1) decency, "the degree to which the formation and stewardship of the rules is undertaken without harming or causing grievance to people;" (2) transparency, "the degree

[264] Victor Thuronyi, *Turkey's Income Tax Laws in International Comparison*, www.undp.org.tr/demGovDocs/TaxPolicy/Thuronyi_Turkey.DOC (last visited Feb. 16, 2010).

[265] BRIAN C. SMITH, GOOD GOVERNANCE AND DEVELOPMENT 2 (2007). Besides the collapse of Soviet bloc, Smith counts some other political developments that came together to prompt donors to adopt good governance conditionality: democratization was already underway in other parts of the world by 1990 so the indigenous pro-democracy movements provided the West with legitimacy for its pro-democracy aid policies; domestic political pressures in donor countries encouraged a demand for good governance as a condition of being given; in the 1990s, blame for the failure of structural adjustment and economic liberalization to achieve the intended beneficial results was directed at poor-quality governance; and it was recognized that governance had itself been affected by aid. *Id*. at 2–3.

of clarity and openness with which decisions are made;" (3) accountability, "the extent to which political actors are responsible to society for what they say and do;" (4) fairness, "the degree to which rules apply equally to everyone in society;" (5) efficiency, "the extent to which limited human and financial resources are applied without waste, delay or corruption or without prejudicing future generations;" and (6) participation, "the degree of involvement of all stakeholders."[266]

The good governance approach may be implemented in different arenas, such as government, public administration, the judiciary, economic society, political society, civil society, and sustainable development. In the context of tax reform, good governance has been understood to improve tax administration and procedure.[267] Tax administration reform has mainly considered the principles of transparency, accountability, and especially efficiency,[268] while neglecting one of the important principles of good governance: democratic participation.[269]

IGOs have wielded "carrots and sticks" to force nations to comply with their ideas. Turkish tax expert Kenan Bulutoglu demonstrated the use of rewards and penalties by saying: "In stimulating a useful flow of information to tax administrators, the fiscal carrot may produce more satisfactory results than the fiscal stick."[270] Instead of using carrots and sticks directly in their relations with nations, IFIs influence

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266 U.N. ECON. COMM'N FOR EUR., GUIDEBOOK ON PROMOTING GOOD GOVERNANCE IN PUBLIC-PRIVATE PARTNERSHIPS 13–14 (2008). *See also* U.N. Econ. & Soc. Comm'n for Asia and the Pacific, *What is Good Governance?*, *available at* http://www.unescap.org/pdd/prs/ProjectActivities/Ongoing/gg/governance.pdf (last visited Feb. 26, 2010). *See generally* COMMONWEALTH SECRETARIAT, CURRENT GOOD PRACTICES AND NEW DEVELOPMENT IN PUBLIC SECTOR SERVICE MANAGEMENT (2002).

267 *See* Stewart, *Global Trajectories*, *supra* note 3, at 183.

268 *See, e.g.*, RICHARD MILLER BIRD & MILKA CASANEGRA DE JANTSCHER, IMPROVING TAX ADMINISTRATION IN DEVELOPING COUNTRIES (1992); Carlos Silvani & Katherine Baer, *Designing a Tax Administration Reform Strategy: Experiences and Guidelines* (Int'l. Monetary Fund, Working Paper No. WP/97/30, 1997), *available at* http://www.imf.org/external/pubs/ft/wp/wp9730.pdf; Jit B.S. Gill, *The Nuts and Bolts of Revenue Administration Reform*, WORLD BANK (Jan. 2003), http://siteresources.worldbank.org/INTTPA/Resources/NutsBolts.pdf; Richard M. Bird, *Administrative Dimensions of Tax Reform*, ASIA-PAC. TAX BULL., Mar. 2004, at 135, *available at* http://unpan1.un.org/intradoc/groups/public/documents/UNPAN/UNPAN015761.pdf.

269 *See* Stewart, *Global Trajectories*, *supra* note 3, at 183.

270 Bulutoğlu & Thirsk, *supra* note 36, at 363.

nation states indirectly by using non-state actors to induce developing countries to comply with their international commitments to the IFIs.[271]

"Public participation" in the national policymaking process has become an indirect way of using international institutions to influence domestic politics.[272] Participation by interest groups is thought to raise rates of compliance with commitments.[273] For example, the World Bank states that public participation improves the effectiveness of the Bank's development projects and programs.[274] Thus developing country

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[271] Non-state actors are epistemic communities, non-governmental organizations, and domestic constituencies. Epistemic communities refer to networks of knowledge-based experts and have been defined as a "network of professionals with recognized expertise and competence in a particular domain and authoritative claim to policy-relevant knowledge within that domain or issue-area." Peter Haas, *Knowledge, Power and International Policy Coordination,* 46 INT'L ORG. 3 (1992). Epistemic communities have been recognized as new non-state actors of international relations theory. *See*, Emanuel Adler and Peter M. Haas, *Epistemic Communities, World Order, and the Creation of a Reflective Research Program*, 46 INT'L ORG. 368 (1992). For a study on epistemic communities in international tax law and policy, *see*, Diane Ring, *Who is Making International Tax Policy?: International Organzations as Power Players in a High Stakes World, available* at http://ssrn.com/abstract=1542646 (last visited Mar. 4, 2010). Non-governmental organizations (commonly known as NGOs) refer to representatives of "civil society." They are not the creation of states, so they are a non-state actor of intentional relations. They are formed by individuals or private groups sharing a common objective, including humanitarian, health, human rights and environmental matters; professional and scientific associations; federations and international unions made up of national associations representing labor or employers; religious bodies; scientific academies; and so on. *See*, LORI F. DAMROSCH, LOUIS HENKIN, RICHARD CRAWFORD PUGH, OSCAR SCHACHTER & HANS SMIT, INTERNANIONAL LAW: CASES AND MATERIALS, 359 (2001); W. MICHAEL REISMAN ET. AL., INTERNATIONAL LAW IN CONTEMPORARY PERSPECTIVE 290 (2004). *See*, XINYUAN DAI, INTERNATIONAL INSTITUTIONS AND NATIONAL POLICIES, 23 (2007). The current director of Fiscal Affairs Department of the IMF, Carlo Cottarelli expressed the importance of domestic institutions to compliance with international commitments, saying that states with strong budget institutions and independent central banks are more likely to sustain a commitment to adjustment backed by the IMF. *See*, CARLO COTTARELLI, LIMITING CENTRAL BANK CREDIT TO THE GOVERNMENT: THEORY AND PRACTICE, IMF OCCASIONAL PAPER 110 (1993).

[272] *See*, THE WORLD BANK, PARTICIPATION SOURCEBOOK (1996), available at, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1996/02/01/000009265_3961214175537/Rendered/PDF/multi_page.pdf (last visited Feb. 15, 2010); OECD, CITIZENS AS PARTNERS: INFORMATION, CONSULTATION AND PUBLIC PARTICIPATION IN POLICY-MAKING (2001); TIM JONES AND PETER HARDSTAFF, DENYING DEMOCRACY: HOW THE IMF AND WORLD BANK TAKE POWER FROM PEOPLE 5 (2005), *available at* http://siteresources.worldbank.org/INTPRS1/Resources/PRSP-Review/WDMPRSPsdoc.pdf;

[273] *See*, THE IMPLEMENTATION AND EFFECTIVENESS OF INTERNATIONAL ENVIRONMENTAL COMMITMENTS: THEORY AND PRACTICE (Victor David, Kal Raustiala, and Eugene Skolnikoff eds., 1998).

[274] WORLD BANK, WORLD DEVELOPMENT REPORT: THE STATE IN A CHANGING WORLD 110 (1997), *available* at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1997/06/01/000009265_3980217141148/Rendered/PDF/multi0page.pdf (last visited Mar.10, 2010).

governments have enacted laws aimed at the new rhetoric.[275] The changes in Turkish tax law and procedure also have been affected by this new rhetoric.

New laws have been enacted for the purpose of enabling democratic participation in the lawmaking process. However, this participation should be analyzed carefully. To a great extent, legitimacy may be seen as simply another rhetorical tool for fulfilling existing instrumental goals, rather than a democratic goal to be carefully analyzed and pursued through iterative processes. IGOs do not appear to seek public participation in order to make the process of reform more democratic. Rather, they seek more public acceptance in order to achieve more effective implementation of existing goals.[276]

The following part examines how Turkey enacted, but failed to internalize, increased participation approaches in its tax reform processes. Examining the outcomes of the 2006 CIT Act illustrates how democratic participation efforts and taxation ideas continue to derive from external agencies and related experts.

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[275] Bolivia passed laws in 1994, 2000 and 2004 to provide a legal and institutional framework for emerging consultation culture. The consultative process was constituted as an effort by the government to consult at the national, regional, and local levels with the support of external partners' technical and financial assistance. *See*, Federico Steinberg, *Institutionalized Participation, Country Ownership, and Poverty Reduction in Bolivia: A Case Study in the Political Economy of the PRSP*, *available* at http://info.worldbank.org/etools/docs/library/106189/BoliviacasestudySantaCruzCourse.pdf (last visited Feb. 19, 2010) (discussing success of World Bank supported poverty reduction strategy and contribution of consultative process on it).

[276] Ghana has also had a similar experience. The VAT reform of 1995 in Ghana caused public violence and in the end failed. However the VAT was introduced again in 1998 and became successful. Stewart explains that this was a result of concerted effort of political consultation and compromise. I think the Ghanaian VAT process shows that participation in lawmaking procedure targets implementation of a practice only if it is backed by the World Bank. Stewart explains the process in these words: "A year after the riots, the government initiated a consultation with individuals, trade unions and professional groups, moderated by World Bank, which resulted in a recommendation to reintroduce the VAT. Business leaders, in particular local directors of multinationals such as Unilever, called strongly for its reintroduction. A VAT Oversight Committee was established which included professional associations and industry bodies, such as the Ghana Urban Traders' Association. The government also carried out further widespread consultations and education of members of parliament and of the public. The opposing party continued to express its opposition to the VAT and there appears to have been a broad public debate about it. The government obtained feedback on key concerns of the public, which included the potential for corruption in VAT administration and, more fundamentally, whether the public would benefit from the increased tax revenues. This public debate led to some important compromises. Most importantly, the VAT was introduced in 1998 with a rate of only 10 percent, recommended by the parliamentary Finance Comitte and by most industry and labour groups, and with an increased range of exemptions." *See*, Stewart, *Tax Policy Transfers, supra* note 3, at 193-4.

V. THE DOMESTIC POLITICAL LEGITIMACY OF TAX REFORM

Turkey's 2001 economic program was followed by democratization of the tax lawmaking process. There were increased efforts to qualify public comment and participation in policy and law-making procedures. A regulation gave public notice and comment requirements to all legislative and procedural regulations, including tax laws and regulations.[277] Another regulation gave legal status to the Tax Council, which cooperated with the Ministry of Finance to draft tax laws.[278] The council had members from both the government and public professional organizations and civil society organizations and was charged with mediating public participation in policy and law-making processes.[279] Besides passing new laws requiring public participation in the lawmaking procedure, the UN moderated a project entitled "Active Civil Society Participation to Legislative Procedure in Turkey."[280]

When the needs of public participation are examined,[281] it can be seen that the target of these measures is not for tax reform, but to create enough space to implement the international taxation trends successfully. This can be seen clearly in the case of the new CIT Act of 2006. The novel substantive outcomes of the new law — arm's length pricing methods and advance pricing agreements (APAs) — simply transplanted existing, extrinsic norms from the OECD Transfer Pricing Guidelines for

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[277] Mevzuat Hazirlama Usul ve Esaslari Hakkinda Yonetmelik (Regulation on Procedures and Principles Regarding Preparing Legislation) (RG: February 17, 2006/ 26083), *also available* at http://www.mevzuat.gov.tr/MevzuatMetin/3.5.20059986.pdf (last visited Sep. 1, 2011).

[278] 5228 sayili Bazi Kanunlarda ve 178 sayili Kanun Hukmunde Kararnamede Degisiklik Yapilmasi Hakkinda Kanun (the Law of 5228 Amending Some Laws and Decree Law of 178), Art. 41 (RG: July 31, 2004/ 25539), *also available* at http://www.tbmm.gov.tr/kanunlar/k5228.html (last visited Sep. 1, 2011).

[279] *See, infra* V, A.

[280] The agreement between Turkey and the UN was signed in June 19, 2008 and approved with the Ministers Council Decision of 2008/14502 (RG: January 16, 2009/ 27112) http://www.resmigazete.gov.tr/main.aspx?home=http://www.resmigazete.gov.tr/eskiler/2009/01/20090116.htm&main=http://www.resmigazete.gov.tr/eskiler/2009/01/20090116.htm. In the context of the project, the Legislative Association (Yasama Derneği) publishes guidelines to make civil society conscious of participation. *See*, e.g., Yasama Derneği, *supra* note 260

[281] There is no study about the needs of public participation to tax lawmaking procedure. Public participation has been comprehensively studied in the international environmental protection field. *See*, SUMUDU ATAPATTU, EMERGING PRINCIPLES OF INTERNATIONAL ENVIRONMENTAL LAW 353-379 (2006).

Multinational Enterprises and Tax Administration (hereinafter OECD Guidelines) into Turkish.[282]

By examining how lawmaking occurs in Turkey, and at which point democratic participation is an option, the next part of this paper outlines the process by which ideas emerge and become rules. I will take note of the interest groups involved in the process, as well as the networks which form around lawmaking in Turkey. One of my goals is to identify which parties are working simultaneously within the Turkish national law-making process and which parties are working within transnational networks. Drawing these connections traces the ideological connections between the national and the transnational.

A. DEMOCRATIC PARTICIPATION IN TURKISH LEGISLATIVE PROCESS

Turkey is a civil law country where law emerges from legislative, judicial, and executive activity. Turkish tax codes are administered simultaneously by the Council of Ministers, the Ministry of Finance, and the Presidency of Revenue Administration (GİB). Each of these constitutes an executive body, rather than a legislative one. The Council of Ministers consists of the prime minister and the group of officials who head each of the government ministries, most (but not all) of whom are members of the TBMM.[283] The Ministry of Finance is an executive department headed by the Minister of Finance, who is also a member of the Council of Ministers.[284] The GİB is the Turkish equivalent of the U.S. Internal Revenue Service. In accordance with the principle of the "legality of taxation," each of these bodies has distinct administrative responsibilities. If the Council of Ministers introduces a law, it is referred to as a "draft bill;" if the deputies do so, it is referred to as a "draft

[282] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (1995). A new version of the OECD Guidelines was published in 2010.

[283] 1982 AY, *supra* note 193, Art. 109 ("The Council of Ministers shall consist of the Prime Minister and the ministers.(1) The Prime Minister shall be appointed by the President of the Republic from among the members of the Turkish Grand National Assembly. (2) The ministers shall be nominated by the Prime Minister and appointed by the Turkish Grand National Assembly or from among those eligible for election as deputies; and they can be dismissed by the President of the Republic, upon the proposal of the Prime Minister when deemed necessary. (3)"

[284] For the list and current members of the Council of Ministers, *see*, http://www.basbakanlik.gov.tr/Forms/pCabinet.aspx (last visited Sep. 1, 2011).

proposal."[285] Under TBMM rules of procedure, draft bills must be signed by all the ministers of the Council.[286]

All Turkish ministries have statutory rules enabling legislation for formation, abolition, functions, powers, and organization.[287] The Ministry of Finance is in charge of national budget affairs, including taxation.[288] The Finance Ministry prepares draft bills concerning revenue collection and expenditures.[289] The Ministry of Finance must consider two regulations which require public participation to lawmaking procedure while preparing draft bills. Since 2006, the Minister of Finance has been required to seek input from local authorities, universities, trade unions, public professional organizations, and civil society organizations.[290] For the CIT draft, the Ministry obtained 155 opinions from civil society organizations, public professional organizations, and universities.[291] Seven of them were trade unions, three were employers' associations, twenty-three were associations and foundations, fifty-two were universities, and seventy were public professional organizations.[292] There has been no disclosure of who gave their opinion and how much those opinions affected the draft.

The Ministry of Finance is required to coordinate with the Tax Council while preparing drafts.[293] The Tax Council consists of fifty-two individuals.[294] The Finance Ministry Secretary,[295] the President of

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285 1982 AY, *supra* note 193, Art. 88.

286 Türkiye Büyük Millet Meclisi İçtüzüğü (The Rules of Procedure of Turkish Grand National Assembly (hereinafter "İçtüzük"), Art. 73/1 (RG: April 13, 1973/ 14506), *available* at http://www.tbmm.gov.tr/ictuzuk/ictuzuk.htm (last visited Sep. 1, 2011).

287 1982 AY, *supra* note 193, Art. 113/1.

288 Maliye Bakanliginin Teskilat ve Gorevleri Hakkinda Kanun Hukmunde Kararname (the Decree Law on the Establishment and Duties of the Ministry of Finance), Art. 1. (RG: December 14, 1983, 18251bis.) *also available* at http://www.mevzuat.gov.tr/Metin.Aspx?MevzuatKod=4.5.178&MevzuatIliski=0&sourceXmlSearch=178.

289 *Id.*, Art. 2/h.

290 Mevzuat Hazirlama Usul ve Esaslari Hakkinda Yonetmelik, *supra* note 277, Art. 6 (2).

291 *See*, VERGI KONSEYI, KURUMLAR VERGISI KANUNU TASARI TASLAĞI (2005), http://www.vergikonseyi.org.tr/calismalar.php?detay=98b8c755ec0489ed252061e1e9c612fa (last visited Sep. 1, 2011).

292 *Id*. at 8-13.

293 Vergi Konseyi Yonetmeligi (Regulation of the Tax Council), Art. 1 (RG: March 22, 2005/ 26763), *also available* at http://mevzuat.basbakanlik.gov.tr/Metin.Aspx?MevzuatKod=7.5.7570&MevzuatIliski=0&sourceXmlSearch=vergi konseyi yönetmeliği (last visited Sep. 1, 2011).

294 *Id.* at Art. 5.

295 This individual is the principal assistant to the Finance Minister.

Revenue Administration,[296] and the Director General of Income Policy[297] have a permanent seat on the Tax Council, along with one secretarial staff member.[298] The group of civil society organizations, the group of public sector, and selected members has representative seats.[299] The group of civil society organizations has eighteen members to the Tax Council.[300] The Regulation of Tax Council does not specify the civil society organizations groups allowed on the council. The regulation instead refers generally to public professional organizations, small traders and craftsmen confederations, trade unions and employers' associations, associations, foundations, and other civil society organizations.[301] Although civil society organizations are allowed to designate their own delegates, in practice the Finance Minister determines which civil society organizations will be invited to send a delegate. When the CIT draft was prepared, the civil society organizations group consisted of eleven public professional organizations,[302] four associations and foundations,[303] two trade unions,[304]

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296 This individual is the principal director of GİB, a role equivalent to the Commissioner of the IRS in the US.

297 This is the head of tax policy within the Finance Ministry, and is not connected with the GİB.

298 Vergi Konseyi Yonetmeligi, *supra* note 293, Art. 5.

299 *Ibid.*

300 *Ibid.* These are for 4 representatives from the Ministry of Finance and a representative from the Ministry of Justice, the State Planning Organization, the Undersecretariat of Treasury, the Investor Relations Office, the Undersecretariat of Customs, the Banking Regulation and Supervision Agency, the Capital Markets Board, and the Central Bank of the Republic of Turkey.

301 Vergi Konseyi Yonetmeligi, *supra* note 293, Art. 5.

302 Türkiye Odalar ve Borsalar Birliği (Turkish Chambers and Commodity Exchanges Union) (TOBB), Deniz Ticaret Odası (Chamber of Shipping) (DTO), Türkiye Serbest Muhasebeci Mali Müşavirler ve Yeminli Mali Müşavirler Odaları Birliği (Turkish Certified Public Accountants Chambers Union) (TÜRMOB), Türkiye Bankalar Birliği (Turkish Banks Union) (TBB), Türkiye Ziraat Odaları Birliği (Turkish Agriculture Chambers Union) (TZOB), Türkiye Katılım Bankaları Birliği (Turkish Participation Banks Union)(TKBB), Türkiye İhracatçılar Meclisi (Turkish Exports Council) (TİM), Türkiye Sermaye Piyasası Aracı Kuruluşları Birliği (Turkish Capital Market Intermediary Institutions Union) (TSPAKB), Türkiye Sigorta ve Reasürans Şirketleri Birliği (Turkish Insurance and Reinsurance Companies Union) (T.Sig.Res.Şirk.Birliği), Türkiye Müteahhitler Birliği (Turkish Contractors Union) (TMB), Türkiye Esnaf ve Sanatkarları Konfederasyonu (Turkish Small Traders and Craftsmen Confederation) (TESK). *See*, http://www.vergikonseyi.org.tr/hakkimizda.php?baslik=8f14e45fceea167a5a36dedd4bea2543 (last visited Sep. 1, 2011).

303 Türkiye Sanayicileri ve İş Adamları Derneği (Turkish Industrialists' and Businessmen's Association) (TÜSİAD), Müstakil Sanayici ve İş Adamları Derneği (Independent Industrialists' and Businessmen's Association) (MÜSİAD), Vatandaşın Vergisini Koruma Derneği (Protecting Citizen'sTax Association) (VAVEK), Yabancı Sermaye Derneği (Foreign Investment Association) (YASED). *See*,

and one employers' association.[305] The group of public sector has twelve members: four representatives from the Ministry of Finance, one representative from the Ministry of Justice, the State Planning Organization, the Undersecretariat of Treasury, the Investor Relations Office, the Undersecretariat of Customs, the Banking Regulation and Supervision Agency, the Capital Markets Board, and the Central Bank of the Republic of Turkey.[306] Finally, the Finance Minister can nominate an additional eighteen delegates from selected sectors, including economics, finance, and tax experts, at least nine of whom are from universities.

The Ministry of Finance introduced the 2006 CIT Act draft to the Council of Ministers and the Council of Ministers decided to submit the new corporate income tax act draft bill to the Parliament.[307] The Parliament's Speakership assigned the bill number and transferred it to the Plan and Budget Committee for consideration.[308]

The members of the Plan and Budget Committee are outlined in the Constitution— they include deputies, at least twenty-five of which must be affiliated with the ruling party.[309] The Plan and Budget Committee discusses the bills in meetings attended by committee deputies and the Prime Minister or a minister, as well as government agents, members of TBMM, and members of the Council of Minister.[310]

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http://www.vergikonseyi.org.tr/hakkimizda.php?baslik=8f14e45fceea167a5a36dedd4bea2543 (last visited Sep. 1, 2011).

304 Türkiye Kamu Çalışanları Sendikaları Konfederasyonu (Confederation of Turkish Public Trade Unions) (KAMUSEN), Türkiye İşçi Sendikaları (Confederation of Turkish Trade Unions) (TÜRK-İŞ). *See*, http://www.vergikonseyi.org.tr/hakkimizda.php?baslik=8f14e45fceea167a5a36dedd4bea2543 (last visited Sep. 1, 2011).

305 Türkiye İşveren Sendikaları Konfederasyonu (Confederation of Turkish Employers' Associations) (TİSK). *See* http://www.vergikonseyi.org.tr/hakkimizda.php?baslik=8f14e45fceea167a5a36dedd4bea2543 (last visited Sep. 1, 2011).

306 Vergi Konseyi Yonetmeligi, *supra* note 293, Art. 5.

307 Kurumlar Vergisi Kanunu Tasarısı ile Plan ve Butce Komisyonu Raporu, Donem: 22, Yasama Yili: 4, *available* at http://www.tbmm.gov.tr/sirasayi/donem22/yil01/ss1192m.htm (last visited Sep. 6, 2011).

308 Id.

309 1982 AY, *supra* note 193uu, Art. 162. The Plan and Budget Committee is the only committee for which a number of members and affiliation requirements are delineated in the Constitution—the number and affiliation of members on all other committees are unspecified. For more information about the Plan and Budget Committee, *see*, Ercan Celiker, *Plan ve Butce Komisyonu: Gelisimi ve Yasama Surecindeki Islevi*, 2 Yasama Dergisi 5-31(2006), *also available* at http://www.yasader.org/web/yasama_dergisi/2006/sayi2/plan_ve_butce_komisyonu.pdf (Sep.6, 2011).

310 İçtüzük, *supra* note 286, Art. 30, 31.

Other than these people, essentially no one else can attend the Committee meeting,[311] but, in practice, the President of the Committee invites public professional organizations and civil society organizations to the committee meetings.[312] This group of attendees may speak, but cannot bring up a motion or vote.[313] The President of the Chambers of Commodity Exchanges of Turkey commented there should be a mention in The Rules of Procedure regarding public attendance at the legislative level.[314] Otherwise, participation relies on the parlimentary committee.

Similar to the Plan and Budget Committee meeting, public participation in the parliament session is not technically allowed, yet is tolerated in practice.[315] The new CIT was discussed on June 13, 2006. After debate, the TBMM voted to enact the draft bill into law the same day.

As this study shows, public participation in the legislative process occurs at two different levels. At the executive level, the Tax Council allows public participation, and the opinion of the public regarding drafts may also be submitted to the Ministry of Finance. At the legislative level, public participation occurs through committee meetings.[316]

A preponderance of capital owners at the executive level can be seen in the 2006 CIT Act procedure. Employers' associations and the majority of associations, foundations, and public professional organizations were institutions that advocate for capital owner's interests and constitute a large part of the people who were asked for their opinion by the Ministry of Finance.[317] Most institutions in the civil society organizations group, which were invited by the Ministry Finance to the Tax Council, also advocate for capital owner's interests.[318] The Ministry of Finance's decision to ask and invite certain institutions reflects the political alignment of the current government. As a defense, it can be said that the subjects of the act are corporate, so capital owners' interest

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311 İçtüzük, *supra* note 286, Art. 166/1.

312 *See*, Yasama Derneği, *supra* note 260, at 81.

313 İçtüzük, *supra* note 286, Art. 31/2.

314 *Id*.

315 *See*, Yasama Derneği, *supra* note 260, at 82.

316 Rifat Hisarciklioglu, *Yasama Sürecine Sivil Toplum Katılımı: Bir Sistem Arayışı Paneli* 4 (November 19, 2007), *available* at http://www.yasader.org/web/faaliyetler/19-11-2007-panel/panel_tutanaklari.pdf (last visited Mar. 9, 2010).

317 *See*, Vergi Konseyi, *supra* note 291.

318 *See*, *supra* notes 302, 303, 305.

were directly affected by the 2006 CIT Act. However, tax reform has the potential to redistribute resources from one segment of society to another.[319] So all of society has an interest in tax law and participation of all interest groups must be ensured in tax lawmaking.

B. OUTPUTS OF TAX REFORM

Turkey enacted a new Corporate Income Tax Act in 2006.[320] This Act announced several new innovations to the CIT.[321] However, there are actually very few changes in the 2006 CIT Act. These changes are a part of global tax standards determined by the IGOs, particularly the OECD. In this subpart, I will show the extent to which an international architecture of tax policy expertise played a role in new Turkish tax norms through an examination of the new rules regarding reduced tax rates as well as some transfer pricing issues.

1. TAX RATE

An international practice of reducing corporate income taxation for tax competitiveness has emerged in developed countries and spread to developing countries.[322] Developing countries have adopted this practice because international standards constrain the taxation of developing countries in the name of competition.[323] The Turkish legislative body has not been immune from this trend and has enacted corporate tax rate reduction in order to maintain tax competitiveness.[324] As a result, Turkey is one of the countries with the largest tax rate reduction in the last ten years.[325]

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[319] *See* United Nations Department of International Economic and Social Information and Policy Analysis, World Economic and Social Survey 65 (1997) *available at*, http://www.un.org/esa/policy/wess/WESS%20since%201948/world%20economic%20and%20social%20survey%201997.pdf (last visited Feb. 15, 2010).

[320] *See supra* II, D.

[321] *See* DELOITTE, *The New Corporate tax Law and Implications*, *available at* htt://www.deloitte.com/view/en_TR/tr/services/tax-legal-services/167f95df7e1fb110VgnVCM100000ba42f00aRCRD.htm (last visited Sep. 1, 2011).

[322] Christians, *Global Trends, supra* note 3, at 12.

[323] *Id.,* at 13.

[324] *See* Kurumlar Vergisi Kanunu Genel Gerekçe ve Madde Gerekçeleri, *supra* note 261, at. 2.

[325] *See* KPMG'S CORPORATE AND INDIRECT TAX RATE SURVEY (2007), *available* at http://www.kpmg.com.om/PDF/KPMG%27s%20Corporate%20&%20Indirect%20Tax%20rate%20survey%202007.pdf (last visited, Feb. 15, 2010). Turkish corporate tax rates between 1999-2009 are as follows: 1999 (33), 2000 (33), 2001 (33), 2002 (33), 2003 (33), 2004 (33), 2005 (30),

2. ARM'S LENGTH PRICING METHODS AND ADVANCE PRICING AGREEMENTS

The 2006 CIT Act's transfer pricing rule prevents transactions between related enterprises that are not arm's length.[326] According to the legislative documents of the 2006 CIT Act, the new transfer pricing article is based on international regulations, specifically OECD regulations. Article 13 states that: "The institution of disguised earning distribution by transfer pricing' is regulated taking into consideration international development especially OECD arrangements by this article."[327] The prior CIT Act of 1949 also incorporated some rules regarding transfer pricing into Article 17.[328] The new rules replicate the rules written in the 1949 law except for the two rules regarding transfer pricing. The structure and function of the new rules on transfer pricing in the 2006 CIT Act show the OECD influence Turkish tax law-making.[329]

The first innovation of the transfer pricing rule in the 2006 CIT Act is arm's length pricing methods. The prior CIT Act prevented transactions which were not arm's length, but provided no specific rules for determining how arm's length transactions would be defined. The 2006 CIT Act created specific standards for determining when transfers violated the law. According to ground, Article 13 defines the arm's length pricing principle based on OECD Guidelines.[330] Article 13 specifically names three arm's length methods: (1) the comparable uncontrolled price method (CUP), (2) the resale price method (RPM), and (3) the cost-plus method (CPM).[331] These are the three basic methods

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2006 (20), 2007 (20), 2008 (20), 2009 (20). KPMG'S CORPORATE AND INDIRECT TAX RATE SURVEY (2007), *available* at, http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/KPMG-Corporate-Indirect-Tax-Rate-Survey-2009.pdf (last visited Mar. 4, 2010).

326 5520 sayili Kurumlar Vergisi Kanunu Article 13 (The Corporate Income Tax Act of 5420) (RG: June 21, 2006; 26205).

327 *See* Kurumlar Vergisi Kanunu Genel Gerekçe ve Madde Gerekçeleri, *supra* note 261.

328 Cihat Oner, *Transfer Pricing Rules in the New Turkish Corporate Income Tax Act*, 35 INTERTAX 414-418 (2007).

329 *See id.* at 415-418.

330 *See* Kurumlar Vergisi Kanunu Genel Gerekçe ve Madde Gerekçeleri, *supra* note 261.

331 The CUP sets the arm's length price for a transfer of intangible property by reference to the amount charged in comparable uncontrolled transactions. Comparable uncontrolled Transaction Method, in INTERNATIONAL TAX GLOSSARY, 70 (Barry Larking ed., 2001). The RPM sets the arm's length price for property purchased from an associated enterprise by reference to the resale price margin realized from sale of the same or similar property in comparable uncontrolled transactions. Resale Price Method, in INTERNATIONAL TAX GLOSSARY, 294 (Barry Larking ed., 2001).The CPM sets the arm's length price for the transfer of property or services by reference to

for transfer pricing, specified in the OECD guidelines as "traditional transaction methods."[332]

In addition to these three listed methods, Article 13 stated that "if none of these methods can be used to calculate the arm's length price, taxpayers may apply any other appropriate methods in the transaction concerned with transfer pricing."[333] Taxpayers were free to select a method. According to the ground of Article 13:

> (T)he taxpayer can decide the method unilaterally or use either of the OECD's methods presented in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,[334] and any other methods in practice in other countries which are not provided by the article. The most practical methods in this context are the profit split method and the transactional net margin method which are referred to as 'other methods' in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. These might be used to approximate arm's length conditions when traditional transaction methods cannot be applied.[335]

Another innovation of the 2006 CIT Act is its advance pricing agreements. Transfer pricing rules introduce the option for taxpayers and the administration to enter into pricing agreements. Advance pricing agreements set out the parties' statements on a method for determining the prices of transactions between related companies, for a maximum of three years. Once the terms are agreed on, the advance pricing agreement binds both parties to abide by its terms regardless of conflicting or contrary regulations or revenue rulings which may exist before or arise after the agreement is concluded.[336] The ground of Article 13 states: "This is an implementation called advance pricing arrangements or advance pricing agreements which are suggested in the

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the functions performed by the taxpayer or by reference to comparable uncontrolled transactions. Cost-Plus Method, in INTERNATIONAL TAX GLOSSARY, 70 (Barry Larking ed., 2001).

[332] OECD Transfer Pricing Guidelines Ch. II, Part C.

[333] *Id.*

[334] For the Guidelines, *see, supra* note 282.

[335] *Id.*

[336] 5520 sayılı Kurumlar Vergisi Kanunu, *supra* note 72, Art. 13 (5).

OECD Guidelines and exists in several developed countries' tax systems."[337]

The CIT Act specifically authorized the Council of Ministers to issue procedural rules relating to transfer pricing and advance pricing agreements.[338] In response, the Council of Ministers has issued various regulations containing detailed guidance regarding proper methods for arms' length transfer pricing, largely in accordance with international consensus as expressed within guidelines issued by the OECD.[339]

According to this legislative history, the reforms to the corporate tax code were prompted both by international developments in transfer pricing policy that were taking place in OECD countries and by the availability of technical guidance produced by the OECD in the form of the Transfer Pricing Guidelines. Public participation in tax reform, mainly through the Tax Council is only for appearances. It does not affect the outputs. The Tax Council acclaimed the IGOs' tax policies with its CIT Act Draft.[340] The Tax Council deferred to international tax reform discourse and obtained consultation from foreign tax experts in its preliminary reform work.[341] Behind the scenes, international tax trends exist and the Turkish tax reform in 2006 strongly supports this fact.

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337 *Id.*

338 5520 sayılı Kurumlar Vergisi Kanunu, *supra* note 72, Art. 13 (8).

339 *See* 2007/1288 sayılı Transfer Fiyatlandırması Yoluyla Örtülü Kazanç Dağıtımı Hakkında Karar (Decision Number 2007/12888 on Disguised Earning Distribution by Transfer Pricing) (herein after 2007/12888 sayılı Karar) (RG: December 6, 2007; 26722) and 2008/13490 sayılı Transfer Fiyatlandırması Yoluyla Örtülü Kazanç Dağıtımı Hakkında Karar (Decision Number 2008/13490 on Disguised Earning Distribution by Transfer Pricing) (2008/13490 sayılı Karar) (RG: April 13, 2008; 26846). Even though the Act specifies that the authorization is for the issuance of procedural rules, many aspects of transfer pricing rules produce significant substantive effects on taxpayers' interests. This area may well be a test of the durability of the line between legislative rules and procedural rules in Turkey. The Ministry of Finance has also taken the opportunity to issue its own interpretative regulations according to its discretionary administrative power, *see, e.g.*, 1 Seri No'lu Transfer Fiyatlandırması Yoluyla Örtülü Kazanç Dağıtımı Hakkında Genel Tebliğ (Comminique Number 1 on Disguised Earning Distribution by Transfer Pricing (herein after 1 Seri No'lu Transfer Fiyatlandırması Genel Tebliği) (RG: November 18, 2007; 26704) and 2 Seri No'lu Transfer Fiyatlandırması Yoluyla Örtülü Kazanç Dağıtımı Hakkında Genel Tebliğ (Comminique Number 2 on Disguised Earning Distribution by Transfer Pricing)) (RG: April 22, 2008; 26855).

340 *See supra* note 291.

341 Head of the Council referred these international tax policy studies in his presentation: IMF Fiscal Affairs Department Katherine Baer, Taxing the Informal Sector; Richard M. Bird, Managing The Reform Process (2003); WORLD BANK, GLOBALIZATION AND TAX DESIGN IN DEVELOPING COUNTRIES (eds. William F. Fox and Michael J. McIntyre (2003), available at: http://siteresources.worldbank.org/INTTPA/Resources/BirdZoltPaper.pdf; INTRODUCTION TO TAX POLICY DESIGN AND DEVELOPMENT (eds. Richard M. Bird and Eric Zolt, 2004). *See*, Mustafa Uysal, *Turkiye'de Vergi Politikalari Arama Konferansı Sunumu* (2004), *availale at*

VI. CONCLUSION

The Turkish government revealed that the international dimension of economic activities prevents lawmakers from considering only domestic transactions.[342] However, the governments and people of developing countries still have the responsibility for creating their own tax systems. As Miranda Stewart states, "Tax reform discourse needs to push tax reform beyond the needs of the market to the needs of the people themselves in developing countries and transition countries." [343] To achieve this goal, real democratic participation must be part of the tax reform process. Diverse interest groups should establish the terms of the tax policy. Otherwise reforms will only help powerful taxpayers who received the most benefits. Turkey has started to acknowledge participation in tax lawmaking, especially through the Tax Council. Although I criticize both the composition of the Tax Council that envisages specific interest groups associations' participation and the outputs that are the same as the OECD Guidelines, we can use this attempt as a sign of the beginning of democratizing taxation in Turkey.

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http://www.vergikonseyi.org.tr/yayinlar_baslik.php?icerik=e08599ba76fe6afa2b5786d857b0f56e (last visited Feb. 10, 2010). The Council consulted Andrew Miles (British citizen, former PWC worker and adviser to several Ministries of Finance) and Peter Birch Sorensen (Danish academic, has conducted studies with the IMF board) on the subject of reconstruction of income taxation. *See* Vergi Konseyi, *Gelir Idaresinin Yeniden Yapilandirilmasi* (2006), *availale at* http://www.vergikonseyi.org.tr/yayinlar_baslik.php?icerik=e08599ba76fe6afa2b5786d857b0f56e (last visited Feb. 10, 2010).

[342] *See* Kurumlar Vergisi Kanunu Genel Gerekçe ve Madde Gerekçeleri, *supra* note 261.

[343] *See* Stewart, *Global Trajectories, supra* note 3, at 190.