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WORKING PAPER

Political connections and depositor discipline

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Abstract

We analyze how political connections affect depositor discipline in a sample of Turkish banks. Banks with former members of parliament at the helm enjoy reduced depositor discipline, especially if the former politician's party is currently in power, but less so if the former politician served as a minister. Banks with structural problems are more likely to appoint former politicians, but our results remain robust after controlling for selection effects. Ministers may reduce depositor discipline less because they signal severe problems and because the additional government deposits they bring to the bank during their term tend to depart with them.

Keywords Depositor Discipline; Political connections; Banks

JEL G1 ▪ G2 ▪ D7

1. Introduction

For the sake of financial stability, nearly every aspect of the banking business is shaped by regulation. Government policy affects the competitive positions, the profitability and the risk taking behavior of banks by imposing entry and exit barriers, by setting interest rate ceilings, by directly restricting bank activities to a safety set, by guaranteeing deposits and by changing tax rules. Banks' activities and risk taking behavior may also be restricted indirectly by capital, liquidity or leverage requirements, accompanied with appropriate monitoring and supervision provisions to ensure enforcement of regulations. This set of government-imposed constraints provides strong incentives for banks to develop a corporate political strategy that addresses some of these constraints. This is especially the case if institutions are weak enough for regulatory bodies to be subject to political capture (Hellman et al. 2003).[1] Further, the empirical literature suggests that highly concentrated and regulated industries (e.g., Masters and Keim 1985; Schuler et al. 2002) characterized by a few larger firms (Salamon and Seigfried 1977) are more likely to engage in lobbying and campaign activities.[2] This suggests that the banking industry, which is typically highly concentrated, regulated and dominated by big banking firms, is particularly suited to establish political connections and other lobbying activities. One good example of political capture is provided by Laeven (2004) and Demirgüç-Kunt et al. (2008), who find that generous deposit insurance schemes are mainly adopted by countries with poorly capitalized banks as a result of extensive lobbying efforts.

Besides influencing policymaking through the sector's lobbying pressures, banks may even appoint politically connected directors in order to extract more direct and bank-specific rents from the government, that are otherwise unavailable to the bank. In particular, a strong political relationship can be considered as an important intangible asset in dismantling bureaucratic obstacles, attracting public deposit accounts, and receiving preferential treatment in the form of bank-specific reduced supervisory oversight, regulatory forbearance or even bailouts. Depositors may even perceive the presence of politically connected banks directors or chairmen as a signal of an implicit government guarantee. As a consequence of cheap government funding, more flexible

[1] Especially in weak institutional environments, the state has been viewed as a predatory instrument for transferring resources from one group to another (e.g., North 1981, Shleifer and Vishny 1998, Olson 2000). Hellman et al. (2003) report the emergence of a capture economy in many transition countries, where politicians sell rent-generating benefits to private firms. Acemoglu and Johnson (2005), who find that institutions that protect against expropriation by politicians and other powerful groups have a first order effect in explaining income per capita, have further emphasized the importance of strong institutions.

[2] Consistent with these conjectures, Stigler (1971) argues that industries with substantial political influence and cohesiveness circumvent/disrupt government regulation to its advantage.

supervisory and regulatory boundaries and the presence of an implicit government guarantee, politically connected banks may be expected to be subject to less market discipline from the side of depositors. The aim of this paper is testing this conjecture that political connections reduce depositor discipline.

The idea behind market discipline is that investors in bank liabilities actively reward or punish banks in function of the banks' risk taking behavior. In the case of excessive risk taking, investors can demand higher returns on bank liabilities or withdraw their funds. The disciplining of banks involves both price and quantity adjustments of bank liabilities. By making risk taking more costly for banks, depositors restrain banks' incentives to take excessive risk and hence should contribute to the stability of the financial system. This incentive-compatible regulatory design has been strongly stimulated by the Basle II reforms. These were partially intended to remedy the moral hazard cost of the mispriced government guarantees, inherent to the regulatory design of 1934-1984 that focused on safety nets and crisis prevention. Market forces can also remedy other deficiencies of the supervisory framework, like information asymmetries. Even though bank supervisors can conduct on-site examinations, markets may jointly know more than inspections can reveal.

Much of the evidence for depositor discipline comes from countries with mature and relatively transparent banking sectors[3]. Both price and quantity discipline have been shown to prevail in the United States' banking sector, particularly with respect to deposits that are not fully insured. A recent study using cross-country panel data from thirty-two OECD countries confirms the presence of disciplining behavior in other mature institutional environments (Nier and Baumann, 2006). Demirgüç-Kunt and Huizinga (2004) use data from a sample of both OECD and developing countries and find a negative relationship between the implicit cost of bank funds and prior period measures of bank capitalization, profitability and liquidity. The evidence for quantity disciplining is less convincing in their study. Martinez Peria and Schmukler (2001) investigate Central and Latin American countries (Argentina, Chile and Mexico) and demonstrate that banks' deposits increase and their deposit rates generally decrease with a reduction in the percentage of non-performing loans and improvements in liquidity and capitalization. Karas et al. (2010a) show that surprisingly sophisticated and capital-based depositor discipline is also present in a European emerging market like Russia.

By verifying whether depositors impose less discipline on politically connected banks, this paper connects two hitherto separate strands of the literature. The deposit insurance literature

[3] See, amongst others, Flannery and Sorescu 1996, Park and Peristiani 1998, Calomiris and Powell 2001, Evanoff and Wall 2001, Goldberg and Hudgins 2002, Maechler and McDill 2003, and Sironi 2003.

suggests that deposit insurance entails a trade-off between greater protection against bank runs and an increasing propensity of banks to take on additional risk, because depositors no longer have incentives to monitor banks and, hence, do not claim an interest payment commensurate with the bank's risk choice. For instance, Demirgüç-Kunt and Detragiache (2002) find evidence that explicit deposit insurance schemes tend to increase the likelihood of banking crises in a sample of 61 countries over 1980–1997. Most empirical studies do confirm that explicit deposit insurance indeed undercuts market discipline. The cross-country study conducted by Demirgüç-Kunt and Huizinga (2004) conveys that the introduction of a blanket guarantee disturbs the market's incentives too deeply to discipline banks through interest rates. Karas et al. (2010b) exploit a natural experiment to show convincingly that this is also the case for Russia. On the other hand, Martinez Peria and Schmukler (2001) give evidence that small insured depositors still react to bank risk after the introduction of deposit insurance. This indicates that depositors are not only concerned about individual bank insolvency, but also about the solvency of the insurance fund and the willingness of the government to support the insurer (Flannery 1998). These insights may also extend to the effect of political connections on market discipline. If political connections imply an implicit government guarantee, or increase the likelihood of bailout in any other way, they may disturb efficient price formation in deposit markets and hence reduce depositor discipline. This will, however, only occur if depositors believe the political connection will help the connected bank to secure government support.

Our work is also related to an emerging body of research that focuses on the economic value of political connections. Fisman (2001) finds that stock prices of firms connected to Suharto regime are negatively affected by rumors about Suharto's health. In a cross-country setting, Faccio (2006) examines internationally active firms and finds a positive value effect from the entry of a shareholder or director into politics, whereas politicians joining company boards do not increase firm value.[4] Further, it is documented that firms with political ties enjoy preferential treatments such as, soft budget constraints (Claessens et al. 2008 for Brazil; Khwaja and Mian 2005 for Pakistan), easier access to government contracts (Agrawal and Knoeber 2001), favorable IPO conditions (Francis et al. 2009), relaxed regulatory oversight (Stigler 1971; De Soto 1990) and bailout options (Faccio et al. 2006). In addition, Faccio (2006) finds that favorable treatments in

[4] Other papers that found a positive relationship between political connectedness and firm valuation include inter alia: Ferguson and Voth (2009) for Nazi Germany and Johnson and Mitton (2003) for Malaysia.

association with political connection manifest more in countries with weak property rights regimes.[5]

Although, in balance, the literature favors the view that close ties with the government is offering a helping hand, there are some studies claiming the opposite. In a cross-country setting, Boubakri et al. (2008) observe a negative relationship between political connectedness and accounting performance. Fan et al. (2007) find that newly privatized Chinese firms with politically connected CEOs are associated with poor post-IPO performance. Qian et al. (2011) find that minority shareholders are expropriated by controlling owners through their political connections. Bertrand et al. (2007) show that connected French firms pursue political goals by creating jobs at the expense of profitability. These results can be explained with the grabbing hand view (Shleifer and Vishny 1998), i.e., former politicians are more inclined to divert resources for political and personal objectives, rather than for maximizing the value of the firm. This paper differs from above studies by examining the economic effect of a bank's rather than a firm's political connections. We focus on the mechanism of moral hazard. Depositors of politically connected banks may exert less discipline on their banks, helping the connected bank to expropriate rents in the form of an increasing deposit base and lower funding costs, as compared to its peers.

We employ a unique dataset of 79 Turkish banks from 1980 until 2008, for whom we have data on balance sheets, income and expense statements, ownership and political connections. Political connections for firms in most of the developing countries like Turkey are mainly established by putting politicians on their payroll. This provides us a direct measure of political connectedness of the board of directors and is readily observable for depositors, so it may affect market discipline. More indirect ways of exerting political power, like electoral campaign contributions, are likely not observable by depositors in most countries and can therefore not be expected to affect depositor discipline.

We find that Turkish depositors discipline their banks through the capital ratio. Banks with lower capital exhibit lower deposit growth and pay their depositors higher interest rates. The introduction of full-blanket deposit insurance fails to reduce depositor discipline significantly, suggesting that depositors had less than complete trust in the government's pledge to guarantee their deposits. Political connections affect market discipline. Specifically, depositors exert less discipline on their banks when banks' top executives were formerly elected in parliament, unless

[5] The evidence provided by Roberts (1990), Goldman et al. (2009) and Cooper et al. (2010) suggests that the value of political connections can also be important for industrialized countries like the U.S., where markets are well developed and shareholders enjoy a higher level of legal protection.

these served as a cabinet minister. These effects are stronger if the former politician's party is currently in power, lending support to the thesis that the found effect is really driven by political connections to a ruling party. Hiring a former cabinet member is less effective in terms of reducing market discipline because depositors may perceive it as a signal of implicit structural problems the bank can only solve thanks to a former-minister's political clout. In addition, the new government deposits brought by the minister are also fickle and tend to leave the bank with the minister.

We organize this article as follows. The next section describes the sample of banks, discusses the methodology of the depositor discipline model, and presents the baseline results. In Section 3, we test whether the blanket guarantee scheme affected depositor discipline. In Section 4, we interact the bank fundamentals with political connection variables. Section 5 presents robustness checks and explore explanations for the results. In Section 6, we verify whether there is a disparity in depositor discipline between different types of agents. The last section contains concluding remarks.

2. Data and baseline model of depositor discipline

We collect an unbalanced panel of 79 Turkish banks from the various issues of *Banks in Turkey* published by the Banks Association of Turkey. This publication includes balance sheets and income statements for these banks from 1980 until 2008. We chose the year 1980 as a starting point because in July of that year the government embarked on a program of financial liberalization and removed interest rate ceilings on loans and deposits to increase competition in the banking sector. In Appendix 1, we present an overview and short history of the Turkish banking industry. We only use public information that is available to depositors.[6] Of the 79 banks, 33 banks were classified as foreign banks, 50 banks were domestically owned commercial banks and 13 were classified as state-owned deposit taking banks.[7] This study concentrates on commercial banks as they function as universal banks (offering a broad range of products and services such as deposit-taking, commercial lending, trading financial instruments, insurance, leasing and investment banking), and hence operate relatively homogenously. Moreover, we exclude investment banks and State Deposit Insurance Fund banks (SDIF banks) from the sample. Our methodological approach is (i) to infer whether market discipline is present using evidence from both deposit interest rate and deposit

[6] Our data structure is adjusted for mergers & acquisitions by generating a new bank after tracing such events via The Banks Association of Turkey, which offers main historical events during the lifetime of operating and closed banks.

[7] The sum is more than 79, as we account for changes in ownership type over the sample period.

growth regressions, (ii) to address the question whether a full blanket guarantee affects market discipline, and (iii) to assess whether political connectedness hampers depositors' incentives to monitor and discipline their banks. Methodological details are provided section by section.

2.1. A baseline model of depositor discipline

We first examine all the bank fundamentals, in order to explore which variables depositors focus on when disciplining their banks. The most convincing evidence of depositor discipline would emerge if depositors withdraw their funds whenever the asset quality of their bank is no longer satisfactory. Consequently, because of this upward shift of the deposit supply curve, the bank will face deposit outflows and deposit rate hikes. This is why analyzing both the reactions of deposit prices and quantities is important, as only this joint information allows us to disentangle depositor discipline from demand shifts or regulatory shocks (Park 1995, Martinez Peria and Schmukler 2001, Ioannidou and de Dreu 2006, Karas et al. 2010a). A positive relation between bank risk and deposit rates could for example also reflect a demand effect rather than discipline, with risky banks pursuing a more aggressive expansion strategy to meet new loan demand. But this would be revealed by looking at the quantity regression, where the relation between bank risk and deposit quantity would also be positive in case of a demand effect, and negative in case of true depositor discipline.

Using reduced form equations, the following baseline models are estimated in which we measure the reaction of deposits (Eq. 1) and interest rates (Eq. 2) to bank risk taking, respectively:

$$\mathrm{DEPG}_{i,t} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Controls}_{(i),t} + \varepsilon_{i,t} \quad (1)$$

$$\mathrm{IDEP}_{i,t} = \beta_i + \beta_1 \mathbf{Risk}_{i,t-1} + \beta_2 \mathbf{Controls}_{(i),t} + \mu_{i,t} \quad (2)$$

The dependent variables are the traditional measures to evaluate market discipline. The $DEPG_{i,t}$ is the first difference of the log of deposits for bank *i* during period *t*, whereas $IDEP_{i,t}$ is the implicit interest rate on deposits of bank *i* at time *t*. To avoid non-stationarity, the growth rate of the volume of total deposits is used instead of its levels. Table 1 provides summary statistics of the numerical measures of the dependent variables, bank fundamentals and bank controls for the sample period 1980-2008. We notice that the average yearly percentage change in deposits has been positive across banks and over time (16.20%), however, with a high degree of dispersion (58.48%) showing

a substantial difference between minimum and maximum values. On the other hand, the implicit interest rate reveals us that the banking sector has historically paid high interest rates on deposits.

In line with the literature, the **Risk** represents a vector of accounting measures of bank-specific risk characteristics (e.g., Park and Peristiani 1998, Martinez Peria and Schmukler 2001).[8] This vector is included with a one-year lag to account for publication delay of balance sheet and income statement information. Furthermore, this lag structure also helps to reduce potential endogeneity concerns. The capital ratio ($Equity$) is calculated as the ratio of book value of equity to total assets. This ratio serves as a secure cushion against declining bank asset values, and as a signal to outsiders about the solvency of the bank. We expect that this variable will have a positive relationship with deposits and a negative linkage with the interest rates, ceteris paribus. The summary statistics in Table 1 reveal that the average capital ratio in our sample is equal to 12%. The $Liquidity$ variable is equal to liquid assets (such as cash, central bank debt and short-term government securities) to total deposits. As this ratio measures the bank's ability to cover deposit withdrawals, we expect a positive relationship with deposits and a negative one with the interest rates. The $Bad\ loans$ variable proxies for riskier asset management strategy, and is computed as the ratio of loans under follow-up to gross loans. As the presence of high non-performing loans ratio is associated with higher credit risk, all else being equal, we expect this ratio will have a negative impact on deposit growth and positive one on the interest ratio. The ROA is the profit after taxes divided by total assets. As this ratio is an indicator of how profitable a bank is relative to its total assets, it gives an idea about management's effectiveness in asset employment. As a consequence, we expect this variable will have a positive relationship with deposits and a negative linkage with the interest rate, ceteris paribus. To moderate the inordinate influence of extreme values, we winsorize the dependent and bank risk variables at the 2% level in both tails.

Strong evidence of market discipline is found when the signs of the estimated coefficients of bank fundamentals are opposite in both equations, for example for capitalization $\alpha_1 > 0$ and $\beta_1 < 0$. The disturbance terms $\varepsilon_{i,t}$ and $\mu_{i,t}$ are independently distributed with mean zero and variance $\sigma^2_{i,t}$. Following most prior research, we estimate a model using bank fixed effects, α_i, for the deposit reaction, and β_i, for interest rate reaction to control for the unobserved heterogeneity across banks.

[8] Instead of accounting measures, relying on market information would severely restrict our dataset, since most banks in our sample are not listed.

The **Controls** vector contains other bank specific control variables and macro-political variables potentially affecting the reaction variables. The variable $Size$ is calculated as the natural logarithm of the book value of total assets expressed in terms of 1987 prices. The variable Age is a measure for institutional maturity, and indicates the number of years the bank exists. The variable $Emplbr$ is equal to the average number of employees per branch and is interpreted as a measure of bank service quality. Four macro-political variables are included in the model: a government fragmentation variable ($Fragment$), a variable that captures extraordinary military backed governments ($Xordin$), the growth rate of real gross national product ($Bcycle$) to control for business cycle effects and a banking crisis dummy variable ($Crisis$). The $Fragment$ measures the number of government-parties and is calculated as the monthly weighted number of parties in the government in one specific year. In our sample there was one episode of military backed governments: the period 1981-1983 due to a military coup. In line with Demirgüç-Kunt and Detragiache (2002), the banking crisis dummy variable ($Crisis$) takes the value of 1 in 1982, 1991, 1994 and 2000 and 0 in other years. As in Barajas and Steiner (2000) and Mondschean and Opiela (1999) we also address the issue of bank ownership in market discipline. We differentiate between public, private and foreign banks: Public banks (*State-banks*) are predominantly owned by the government, private banks are domestically owned (Private) commercial banks with more than 50% of shares owned by Turkish residents and foreign banks (*Foreign-banks*) are either branches of foreign banks or Turkish banks with at least 50% of their shares owned by non-residents. Private domestic banks will serve as the reference group.

2.2. Estimation results

Estimation results of Eq. 1 and Eq. 2 are summarized in Table 2. Panel A and Panel B represents the results for the quantity and price equations, respectively. In the first four columns of each Panel, the four sets of bank risk variables are estimated separately; while the last column of both panels presents their joint estimations. If we assume a positive sloped deposit supply curve and a negative sloped deposit demand curve, based on the effects of bank fundamentals on deposit growth and interest rate, we can infer whether there is a strong presence of market discipline (Park 1995). In particular, we are interested in the identification of variables that cause deposit supply shifts. An increase in the capital ratio ($Equity$) leads to an increase in deposit growth and a decrease in deposit interest rates, i.e., the major effect is a rightward shift of the deposits supply curve ($\alpha_1 > 0 \; and \; \beta_1 < 0$). In contrast, a higher liquidity position of the bank ($Liquidity$) results in a

higher deposit growth, but also in a higher deposit rate, suggesting that liquidity is predominantly a demand shifter, rather than a supply shifter. Note that the two remaining risk variables ($Bad\ loans$ and ROA) also fail to produce net shifts of the deposit supply curve.

It turns out that only the capital ratio shows convincing evidence of the presence of depositor discipline, since it conclusively lead to a shift of the deposit supply curve (i.e., statistical significant with the expected and opposite signs in both equations). Specifically, depositors are willing to supply more funds to better-capitalized banks at lower interest rates. This suggests that depositors put most weight on the capital ratio in evaluating banks' riskiness. This is not surprising since the capital ratio is a simple but a very powerful indicator of bank risk: the capital ratio serves as a secure cushion against declining bank asset values. It is also a signal to outsiders about the solvency position of the bank to face credit, liquidity, operational, off balance sheet, legal and macroeconomic risk. Consequently, more than any other measures, the capital ratio is extensively used as a proxy for bank risk taking in market discipline studies both in developed and emerging market economies (e.g., Cook and Spellman 1994, Hannan and Hanweck 1988, Park and Peristiani 1998, Martinez Peria and Schmukler 2001, Karas et al. 2010a).

Most bank-specific control variables enter the deposit growth equation as well as the interest rate equation significantly. The $Size$ variable shows us that banks with larger relative size have a competitive advantage as they attract on average more deposits while not having to pay higher interest rates. This probably suggests that depositors perceive larger banks as "too big to fail" as they perform a key role in the functioning of financial markets and payment system. Furthermore, as evidenced by De Jonghe et al. (2012), larger Turkish banks manage their portfolio risk more efficiently and reach a more optimal risk/return profile. We notice that Turkish depositors are eager to deposit their funds, and accept lower interest rates in exchange for a better client oriented bank service quality ($Emplbr$). In order to gain market share in the deposit market, newer banks offer higher interest rates than older banks (Age) in order to attract more deposits. Political fragmentation ($Fragment$) is related to higher deposit growth and higher deposit rates, suggesting that depositors are willing to save more in times of political uncertainty, but not without asking a risk premium to compensate for the higher general uncertainty. All else being equal, crisis years do not invoke significant changes in the deposit and in the price equation. We observe that deposits increase during the military intervention period ($Xordin$), probably because depositors consider deposit accounts a safe haven in troubled times. In good economic times ($Bcycle$), banks pay less

interest rates on deposits, but do not experience higher deposit growth. State-owned banks pay higher interest rates, but still saw their share in the deposit market slide downward. Although foreign-owned banks also pay higher interest rates on deposits, it does not improve deposit growth significantly.

3. Depositor discipline and blanket deposit insurance

In the following two specifications, bank fundamentals are interacted with a full deposit insurance dummy variable in order to examine the impact of a full blanket guarantee on depositor discipline:

$$\mathrm{DEPG}_{i,t} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Risk}_{i,t-1} * \mathrm{DI}_{it} + \alpha_3 \mathrm{DI}_t + \alpha_4 \mathbf{Controls}_{(i),t} + \varepsilon_{i,t} \qquad (1)$$

$$\mathrm{IDEP}_{i,t} = \beta_i + \beta_1 \mathbf{Risk}_{i,t-1} + \beta_2 \mathbf{Risk}_{i,t-1} * \mathrm{DI}_{it} + \beta_3 \mathrm{DI}_t + \beta_4 \mathbf{Controls}_{(i),t} + \mu_{i,t} \qquad (2)$$

where DI is a dummy variable that has a value of 1 for the full blanket guarantee period (1994-2003) and 0 otherwise. The Turkish government instituted full deposit coverage as a response to the collapse of three small banks on May 5, 1994, to reinstate confidence in the banking system. This blanket guarantee was in place for a substantial amount of time, and was even reinforced during the second major banking crisis in 2000. With the stabilization of the banking sector in the aftermath of the 2000-crisis, the insurance coverage was eventually limited to 50 thousand TL on July 5, 2004, a number that still holds as of today (see, e.g., Tanyeri 2010 and Laeven and Valencia 2012 for a detailed discussion).

The coefficients of α_2 and β_2 identify the change in depositor discipline induced by the deposit insurance. In line with theory and previous empirical literature findings, if the blanket guarantee indeed reduced depositor sensitivity to bank capitalization, we expect $\alpha_2 < 0$ and $\beta_2 > 0$. So far, we have reached the conclusion that market discipline takes place through the capital ratio as higher levels of capital buffers lead to *both* higher deposit growth and lower deposit rates. Given the consistent importance of the capital ratio as the only clear driver of depositor discipline, we focus our attention in the remainder of this paper on the capital ratio. Table 3 presents the results of the impact of an explicit full blanket guarantee on depositor discipline via the deposits equation and price equation (respectively, column 1 and 2 of Table 3). Recall that the coefficient of interaction terms $Equity * DI$ in equations (3) and (4) measures the changes in intensity of market discipline

during the full blanket period.[9] The results reveal us that the introduction of a full blanket guarantee did not have much impact on the intensity of depositor discipline. These finding indicates that the adoption of such a scheme was not credible, or that depositors still feared costs related to the recovery of deposits in case of failure (i.e., the costs due to late payments and the foregone interest earnings).

4. Political connections and depositor discipline

Since the major goal of this paper is to estimate changes in intensity of market discipline after a former politician is appointed at the helm of the bank, we estimate the following reduced quantity and price equations, respectively:

$$\mathrm{DEPG}_{i,t} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Risk}_{i,t-1} * \mathrm{DI}_t + \alpha_3 \mathbf{Risk}_{i,t-1} * \mathbf{POL}_{i,t-1} + \alpha_4 \mathrm{DI}_t + \alpha_5 \mathbf{POL}_{i,t-1} + \alpha_6 \mathbf{Controls}_{(i),t} + \varepsilon_{i,t} \quad (5)$$

$$\mathrm{IDEP}_{i,t} = \beta_i + \beta_1 \mathbf{Risk}_{i,t-1} + \beta_2 \mathbf{Risk}_{i,t-1} * \mathrm{DI}_t + \beta_3 \mathbf{Risk}_{i,t-1} * \mathbf{POL}_{i,t-1} + \beta_4 \mathrm{DI}_t + \beta_5 \mathbf{POL}_{i,t-1} + \beta_6 \mathbf{Controls}_{(i),t} + \mu_{i,t} \quad (6)$$

where **POL** is a vector of two sets of bank-specific political connections, i.e., PCON and MIN.

Regression estimations of equations (5) and (6), are reported in Table 3, columns 3 and 4, respectively. Given these estimations, we first verify whether depositors perceive a top bank executive with past political experience as an implicit government guarantee. The coefficients of α_3 and β_3 measure the change in intensity of depositor discipline for the period that the politically connected person (defined as being a former parliamentarian) is at the head of the bank ($PCON$). In particular, if there is a reduction in depositor sensitivity to bank capitalization, we would notice $\alpha_3 < 0$ and $\beta_3 > 0$. We proceed, in columns 5 and 6, by verifying whether depositors react differently to the appointment of former prime ministers or cabinet members (MIN) instead of simple parliamentarians.

[9] Although we estimate the most flexible specification with Equity, Liquidity, Bad loans, and ROA and full set of interactions, in order to facilitate the interpretation of the results, we only report Equity and its interaction with DI in the discussion of results as only Equity proved to be unambiguously leading to depositor discipline. Full results are available upon request.

We use data from a variety of sources published by The Grand National Assembly Turkey, i.e., the parliament of the Republic of Turkey, to identify political connections. Politically connected bank CEOs or Chairmen are sorted into two subgroups. We define political connections ($PCON$) as 1 if the bank's head was previously a member of Turkish parliament and/or served as a cabinet member or prime minister. The variable MIN is set to 1 if the bank's head served as a cabinet member (i.e., prime minister or any other cabinet member). In our analysis, compared to Faccio (2006), we use a more narrow definition of political connectedness as we concentrate on the bank executives that are most visible to the public, namely the bank's CEO and Chairman of the board[10]. Members of the Turkish parliament are retrieved from a three-volume scrapbook, recently published on the website of The Grand National Assembly of Turkey (www.tbmm.gov.tr). The album covers in a structured way the name, a short biographic note (i.e., date of birth – education level – professional experience), and a picture of all the elected parliamentarian in each legislature for the period 1920-2010. Cabinet members are retrieved from the historical archives of the Turkish parliament, where information about ministerial composition of the past governments is available. The names of banks' CEOs and Chairmen are gathered from the various issues of *Banks in Turkey* published by the Banks Association of Turkey. We crosscheck the names of a bank's CEO and Chairman with the names of cabinet ministers and the names covered in the scrapbook. Names that match are verified with biographies available on the Internet and the online archives of various newspapers. Whenever we cannot find any information about banking experience of formerly elected parliamentarians, we do not consider those names as politically connected in order to avoid overstatements in political connections. We focus on the most objective and direct form of political connections, although there are other indirect, more opaque forms, of political connections (ranging from politicians' relatives on the board to less subtle forms such as bribery or corruption).

To summarize the above description: $PCON$ is a dummy variable which takes the value of 1 when a bank CEO or Chairman was previously a member of the Turkish Parliament, and 0 otherwise 0; MIN is a dummy variable which takes the value of 1 when a bank's CEO or Chairman was formerly a cabinet member or prime minister, and 0 otherwise. According to the definitions above, we detect 27 politically connected directors spread over 21 banks (20 private commercial banks and 1 state bank). The number of bank-year observations for former parliament members is equal to 106, whereas this number is equal to 78 for former cabinet members. The average number of years that a former politician is at the top of the bank is equal to four years.

[10] It is reasonable to hypothize that political connections of other board members will not have any effect on market discipline, as these individuals are much less known by the depositors.

Table 3, Column 3, shows that the interaction term $Equity * PCON$ appears in the deposit growth equation with a statistically significant negative sign, i.e., causing an enormous reduction to the $Equity$ coefficient.[11] Adding up the coefficients (1.9772–2.6785 < 0) reveals us that depositors do not impose discipline on the banks at all while the former politician is heading the bank. Furthermore, Column 4 indicates that this interaction term enters the interest rate equation with a significant positive relationship causing a sizeable increase to the $Equity$ coefficient (adding up coefficients: –0.4204+0.4401). These results indicate that risky, less capitalized banks are attracting more deposits and paying lower interest when they appoint a former politician as a Chairman or CEO. We interpret these findings as rightward shifts in the supply of deposits to risky, though politically connected banks. These findings suggest depositors believe that politically connected banks are safer, irrespective of bank fundamentals.

In order to examine possible differential effects between former cabinet members and ordinary parliament members, we include triple interaction terms. This strategy enables us to identify the separate impact of former cabinet members on depositor discipline. Intriguingly, Column 5 shows that the triple interaction term $Equity * PCON * MIN$ enters the deposit equation with a statistically and economically significant positive coefficient. Apparently, compared with ordinary parliamentarians, the presence of a former minister increases the sensitivity of deposit growth to bank capital (1.9741–4.8831 < 1.9741–4.8831+3.4645). Column 6 shows that this triple interaction term also enters the interest rate equation, now with a statistically significant negative impact. Compared to ordinary parliamentarians, this finding suggests that the presence of a former minister also increases the sensitivity of deposit rates to bank capital (–0.4194+0.8148 > –0.4194+0.8148–0.6062). The results seem to indicate that political connections induce a far greater reduction in market discipline if the political connection is through a former member of parliament rather than a former minister. Depositors indeed only seem to reduce their discipline considerably if the politically connected person did not serve as a minister. Clearly, the appointment of former parliamentarians conveys a positive signal, as depositors respond more favorable to banks with low capital (i.e., high risk bank), increasing the quantity of deposits and/or bringing down the interest rates. We see two possible explanations for this unexpected finding with respect to former

[11] Although we estimate the most flexible specification with Equity, Liquidity, Bad loans, and ROA and full set of interactions, in order to facilitate the interpretation of the results, we only report Equity and its interactions with **POL** in the discussion of our results as only Equity proved to be unambiguously leading to depositor discipline.

ministers. First, depositors may fear that in banks with former ministers at the helm, using the terminology of Shleifer and Vishny (1998), the grabbing hand will impair the helping hand. More specifically, depositors may believe that former ministers will extract political benefits at the expense of other bank stakeholders. This phenomenon may also be intensified due to the instability of the governments in which these people served.[12] In Appendix 2, we briefly review the historical developments in the Turkish political landscape. An alternative interpretation is that the appointment of former cabinet members may convey a negative message concerning the bank's financial health. Hiring a former cabinet member may be perceived as a signal of otherwise unobserved structural problems the bank can only solve with the help of a politically well-connected former minister. In Section 5 we will provide evidence that unhealthy banks are indeed more likely to hire former ministers, which is in line with this argument. Later in this section we also show how the additional government deposits brought to the bank by the former minister, tend to leave the bank upon his/her departure (see Figure 1).

In Eq. 7 and Eq. 8 we examine whether our findings are stronger if the party, the former politician is affiliated with, is part of the ruling majority during his/her term at the head of the bank. The variable *GOV* is set to 1 when the party of the politician which is heading the bank is currently in the (coalition) government, and 0 otherwise.[13] The introduction of the triple interaction term $\boldsymbol{Risk} * PCON * GOV$ enables us to examine whether the sensitivity of depositor discipline intensifies when the (last) party of the former politician is currently in power (i.e., GOV). The introduction of the quadruple interaction terms $\boldsymbol{Risk} * PCON * MIN * GOV$ again allows us to differentiate between former cabinet members and parliamentarians.[14] On the one hand, we observe that depositor discipline is completely wiped away for risky, less capitalized banks in periods when the (last) party of the politically connected CEO of chairman is currently in power. This reinforces the identification of our mechanism of political connections: it is the access to current political power that annihilates

[12] A majority of the ex-ministers served in the seventies, a decade of political turbulences and short-lived governments with a strong military intervention in politics. Turkey witnessed during that decade many coalition governments leading to a seriously undermined public confidence in central authority. The public may hold cabinet members responsible for cabinet instability and their presence may therefore not be a good signal to depositors. Depositors may have loathed banks that took these former politicians on board and the ensuing increased depositor discipline might be partially interpreted as a way of settling the score with respect to the former curtailment of democratic rights.

[13] When the affiliated party ceased to exist, we checked whether its successor is in the coalition government during the period that the former politician is at the top of the bank.

[14] We estimate the following reduced form equations: $\mathbf{Y}_{i,t} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Risk}_{i,t-1} * \mathrm{DI}_t + \alpha_3 \mathbf{Risk}_{i,t-1} * \mathrm{PCON}_{i,t-1} * \mathrm{GOV}_{i,t-1} + \alpha_4 \mathbf{Risk}_{i,t-1} * \mathrm{MIN}_{i,t-1} * \mathrm{GOV}_{i,t-1} + \alpha_5 \mathrm{PCON}_{i,t-1} + \alpha_6 \mathrm{MIN}_{i,t-1} + \alpha_7 \mathrm{GOV}_{i,t} + \boldsymbol{\delta}_{i,t}$, with **Y** the reaction variables DEPG and IDEP.

or even reverses depositor sensitivity to bank capital. This is in line with theories of political rent seeking by banks. On the other hand, this effect is again largely absent for former cabinet members.[15]

The previous results raise the question why banks even consider taking these former cabinet members on board in the first place. To understand the exact effect of the presence of a former cabinet member at the bank, we start by analyzing the evolution of the number of deposit accounts of politically connected banks. In Figure 1 we present the average growth rates of the number of deposit accounts of banks led by former cabinet members, over the eight-year window [-4, 0, +3] surrounding his leave. Since the average tenure is four years, this gives a good picture of the deposit flows during and after their term. The years [-4, -1] represent the last four years that the former cabinet member is at the top of the bank; the year 0 is the event-year in which the former cabinet member leaves the bank; and the years [+1, +3] represent the three years after this person leaves the bank. We distinguish between the growth of the number of government deposit accounts and of other (i.e., private) deposit accounts. The reason why banks may believe it is useful to have political connections with former cabinet members, lies in the dashed line that represents the average growth of the number of government accounts in Figure 1. As long as the former politician is still at the helm of the bank, the number of government deposit accounts shows robust growth rates. Apparently former minister use their political clout to bring in deposits from a variety of government organizations. However, this positive effect is annihilated once the former minister leaves and the bank loses its political connection, because the number of government deposit accounts drops sharply in this event. Compared with the growth of the number of government deposit accounts, the number of non-government deposit accounts (the solid line in Figure 1) exhibits lower growth rates before the departure of the former minister, while this is not the case in the period after departure.

5. Robustness

In Eq. 5 and Eq. 6 the political connection dummy variables are lagged by one period, hence they are predetermined in explaining deposits growth and interest rates, respectively. Furthermore, bank-fixed effects control for unobserved bank heterogeneity. But there could still be unobserved time-

[15] Non-significant regression parameters indicated again that the interaction variable $CAP \times DI$ did not affect deposits growth or interest rates. Therefore, to prevent overspecification, the variables DI and $\boldsymbol{Risk} \times DI$ are not included in the following models.

varying bank-specific variables that affect both deposit growth/interest rates and the bank's propensity to appoint former politicians. This is in line with the argument of Demsetz and Lehn (1985), who claim that corporate governance measures can influence performance and vice versa. If there is a selection problem, standard linear regression can produce biased estimates for the effects of political connections on deposits and interest rates. Similar to Campa and Kedia (2002), Villalonga and Amit (2006) we employ the Heckman (1979) two-stage treatment procedure to address this potential selection bias. Specifically, we employ a two-step random effects parametric approach as discussed by Vella and Verbeek (1999), which is an extension of Heckman's two step-procedure to a panel data context. In the first stage, we estimate a random effects probit model in which the dummy variable for political connections is regressed against the same controls as in the previous analyses, and in addition three parameters that distinguish between banks that hire former politicians and those that do not (i.e., conditioning variables).[16] We estimate two probit models for being politically connected (**POL**) – the first examines the determinants of appointing a former politician (PCON), and the second examines the determinants of appointing a politician who served as a cabinet member (MIN). The explanatory variables in both of these selection equations are all lagged with one year, and the conditioning variables are: ln(#govdep + θ), z-score, and a measure for liquidity. The ln(#govdep + θ) is equal to the natural logarithm of the total number of government deposit accounts (#govdep). We add θ, which is equal to 1, because the existence of banks without government deposit accounts would otherwise eliminate observations. The z-score is a measure of bank stability and is calculated as $z = \frac{\text{Mean(EQ/TA+ROA)}}{\text{St.Dev.(ROA)}}$, i.e., average capitalization $\left(\text{EQ/TA} = \frac{\text{Equity}}{\text{Total Assets}}\right)$ and return on assets (ROA) during the four preceding years over the 4-year standard deviation of the return on assets.[17] Banks with a lower z-score are considered to be more risky, i.e., have a shorter distance to default. The liquidity measure, i.e., Liquid/TA, is defined as the ratio of liquid assets to total assets. The results of the first stage are presented in Table 4 – Panel A. In the broader definition (PCON), we find that banks with bad liquidity positions are more likely to appoint leaders with political connections. However, banks that appoint former cabinet members (MIN) may do so in the hope they will use their political clout to remedy some of their profound structural problems. In particular, we find that banks with a low number of government deposit accounts (see previous section), a lower distance to default, and a lower liquidity position are more inclined to hire former ministers, possibly in an attempt to obtain relief for some of their problems.

[16] The fixed effects probit model suffers from an incidental parameter problem, which would yield inconsistent estimates.

[17] For not losing observations over the sample period 1980-2008, we started calculating the z-scores from 1977 onwards.

The fitted values from the first-stage probit are then employed to generate the correction parameter for self-selection (i.e., the inverse of the Mill's ratio). In the second stage analysis, we include the inverse of Mill's ratios. As depositors react differently to the appointment of cabinet members as compared to ordinary parliamentarians, we differentiate between this choice, and include the inverse of the Mill's ratio for being politically connected (λ_{PCON}) and the inverse of the Mill's ratio for selecting only past cabinet members (λ_{MIN}). The results of the second stage regression are presented in Table 4 – Panel B. Our earlier findings are robust. We find again evidence that there is a reduction in depositor discipline for politically connected banks, and that this reduction is mitigated if former cabinet members are appointed. We notice that quantity disciplining and price disciplining are reduced with the appointment of former politicians, and that this reduction in market discipline is mitigated with the appointment of former cabinet member through the quantity equation (Column 1). In the interest rate equation, we observe that market discipline is reduced with the appointment of former politicians (Column 3 and 4), and that this reduction is annihilated with the appointment of a former minister but only if the affiliated party of the former minister is in power (Column 4).[18,19]

The bank fixed effects in Eq.5 and Eq.6 control for time invariant differences between politically connected banks and unconnected banks. The main variable of interest in both of these equations is **Risk** $*$ **POL**, which allows the vector **Risk** to have a different slope for the period that a former politician is at the helm of the bank. However, since bank fixed effects cannot capture differences in slope between politically connected and unconnected banks, the concern is that the coefficient estimate for the interaction term (**Risk** $*$ **POL**) is really capturing the differences between banks

[18] Some papers (e.g., Karas et al. 2010a, Demirgüç-Kunt and Huizinga 2004) argue that, in emerging economies, depositor discipline is displayed more through the quantity equation rather than the price equation as these markets fail to price risk properly because of lack of transparency and asymmetric information.

[19] The two-step random-effects estimator assumes that the error terms measuring bank specific random effects in both equations are not correlated. As both errors mirror bank's non-observable heterogeneity, this assumption may be violated. To test the robustness of our findings, we also use Woolridge's (1995) consistent estimator model for panel data. In the first stage, instead of random effects probit, we estimate a pooled probit model (with standard errors corrected for clustering at the bank level) in determining the determinants of **POL**. These results are very similar as in Panel A of Table 4. In the second stage, instead of random effects model, we estimate a pooled OLS model (with standard errors corrected for clustering at the bank level). For the quantity equation, this approach yields similar conclusions as in Panel B of Table 4 concerning the sensitivity of market discipline with respect to political connections. For the interest equation, the interactions of Equity with political variables (PCON and MIN) preserve the same signs, but they lose some significance. The replication of Column 4 with pooled OLS indicates that the coefficient of Equity x PCON x GOV is significantly negative, while the coefficient of Equity x MIN x GOV is positive but not significant. The findings of this exercise are available on request.

that never have a political connection and banks that do. To overcome this concern, as an additional robustness check, the **Risk** vector included in the previous regressions is allowed to have a different slope for politically connected banks (i.e., *POLBANK*).[20] The $POLBANK$ variable is equal to 1 for all 21 banks that ever hired a former politician in the sample period, and 0 otherwise.[21] To be more precisely, we estimate the following reduced form models:

$$\mathrm{DEPG}_{i,t} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Risk}_{i,t-1} * \mathrm{POLBANK}_i + \alpha_3 \mathbf{Risk}_{i,t-1} * \mathbf{POL}_{i,t-1} + \alpha_4 \mathbf{POL}_{i,t-1} + \alpha_5 \mathbf{Controls}_{(i),t} + \varepsilon_{i,t} \quad (7)$$

$$\mathrm{IDEP}_{i,t} = \beta_i + \beta_1 \mathbf{Risk}_{i,t-1} + \beta_2 \mathbf{Risk}_{i,t-1} * \mathrm{POLBANK}_i + \beta_3 \mathbf{Risk}_{i,t-1} * \mathbf{POL}_{i,t-1} + \beta_4 \mathbf{POL}_{i,t-1} + \beta_5 \mathbf{Controls}_{(i),t} + \mu_{i,t} \quad (8)$$

Regression estimations of equations (7) and (8), are reported in Table 5. The coefficients α_2 and β_2 capture the possible difference in slope for banks that ever appointed a former politician (i.e., POLBANK). The coefficients of α_3 and β_3 measure the change in intensity of depositor discipline for the period that the politically connected director is at the top of the bank (PCON). In particular, if there is a reduction in depositor sensitivity to bank capitalization after the appointment of the political connection, we would notice $\alpha_3 < 0$ and $\beta_3 > 0$. Secondly, in columns 5 and 6, we again verify whether the appointment of former prime ministers or cabinet members (MIN) is perceived differently. We confirm our earlier finding that depositor discipline is reduced for politically connected banks, but this reduction is less dramatic with the appointment of former cabinet members.

6. Depositor discipline and the number of deposit accounts

While our preference for the quantity equation is the first difference of the log of real value of deposits, this was only possible for total deposit liabilities. However, since Turkish data distinguish various deposit categories only via the number of accounts rather than the volumes, we will reproduce our results for the quantity equation with the growth of the number of diverse deposit

[20] Dinç (2005) uses a similar approach as a robustness check in his empirical analysis of government bank lending in election years.

[21] Compared to banks that never hired a former politician as a chief-executive in the sample period (i.e., POLBANK = 0), we observe that banks that banks that ever hired a former politician (i.e., POLBANK = 1) are on average older (50.33 years) and greater in size (i.e., the natural logarithm of total assets in 1987 prices = 13.27), but employ less personnel per branch (24.30).

accounts. For the entire sample period, we can distinguish between the following number of deposit accounts: firm deposits, savings deposits, and interbank deposits. These categories enable us to verify whether there is a disparity in depositor discipline between different types of agents, and how each one reacts to the appointment of a former politician at the head of the bank. Therefore, we estimate the following reduced form equation:

$$\#\mathbf{DEPG}_{\mathbf{i,t}} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Risk}_{i,t-1} * \mathbf{POL}_{i,t-1} + \alpha_3 \mathbf{POL}_{i,t-1} + \alpha_4 \mathbf{Controls}_{(i),t} + \varepsilon_{i,t} \quad (9)$$

where **#DEPG** is a vector capturing the growth in the number of deposit accounts of different agents. We consider the following four sets of variables: #SAVDEPG is the growth in the number of savings deposits; #FIRMDEPG is the growth in the number of firm deposits; #BANKDEPG is the growth in the number of bank deposits; and #PRIVDEPG is the number of private deposits (with private deposits equal to the sum of savings deposits, firm deposits and bank deposits). The results are reported in Table 6. We find some interesting differences in the disciplining behavior between agents. The findings in column 1 indicate that private depositors discipline banks in function of their capitalization, and that the disciplining sensitivity diminishes with the appointment of a former politician, unless he was a former cabinet member. These results are in accordance with the negative signaling hypothesis and in line with our previous findings. We see a similar reaction from firms when banks appointment former politicians. The holders of savings deposit accounts become extremely vigilant when the bank appoints a former cabinet member, but they do not have more faith in banks appointing parliamentarians. Interbank discipline is more than other agents realized through Equity (coefficient estimates are higher than for other agents), and banks do not attach value to the appointment of former politicians.

7. Conclusions

Rather than evaluating the impact of political connections through wealth effects, we attempt to extend our knowledge of the impact of political connections on depositor loyalty by employing a depositor discipline framework. This approach allows us to verify how the average depositor reacts once the bank appoints a former politician. A strong political relationship can be considered as an important intangible asset for banks in several ways. We test whether politically connected banks are less subject to market discipline by depositors.

We find that appointments of former politicians affect depositor discipline substantially. Specifically, depositors discipline their banks less when banks' top executives were formerly elected in parliament. This is especially the case when the former politician's party is currently in power, providing further evidence that our results indeed identify a political channel. However, this reduction in depositor discipline is partially or fully mitigated when the politician concerned also served as a cabinet minister. This could be due to the fact that many of these former ministers were part of controversial governments, soliciting negative reactions by depositors. But we also provide evidence that banks are more likely to appoint former ministers if they are less liquid and closer to default, suggesting that appointing a minister may also send a bad signal of otherwise unobserved bank health to depositors. In addition, the additional government deposits former ministers attract during their term at the bank tend to leave the bank upon their departure. All our results with respect to the effect of political connections on depositor discipline are robust to controlling for possible selection effects.

Appendix 1: Turkish Banking System

Initiated in 1980, the financial liberalization reforms abandoned almost immediately interest rate ceilings, removed quantitative controls on lending, facilitated bank entry and stimulated financial innovation. Since the banking reforms, Turkish banking system experienced a troublesome transformation from government dominancy to private competition and dealt with two minor (in 1982 and 1991) and two major banking crises (in 1994 and 2000). Turkish commercial banks operate as universal banks (offering a broad range of products and services such as deposit-taking, commercial lending, trading financial instruments, insurance, leasing and investment banking) that are largely homogenous. Before liberalization, the banking sector has been significantly under state control and practically no new banks were allowed to be founded in this period. There were interest rate ceilings on deposits and loans and maximum limits on loan sizes in line with the pursued import substitution strategy. In an environment of non-price competition, bank competition was heavily focused on customer convenience leading to the race in the establishment of larger bank networks in order to raise more deposits. Table A1 illustrates that the average number of branches increased by almost 390 % and the average number of employees rose by more than 400% between 1963 and 1980. These rates of increases, however, decelerated after 1980. After the liberalization of the market, the number of banks operating in the Turkish banking sector increased significantly because the large demand of profitable public borrowing and the presence of a full blanket deposit guarantee attracted a considerable number of new entrants. The number of banks sharply dropped from more than 50 to only 33 in the aftermath of the 2000/2001 financial crisis. This shakeout occurred through the liquidation of banks with a weak capital basis and through voluntarily mergers and acquisitions. Despite decreasing bank numbers, the banking assets grew massively after the crisis from $118 billion in 2002 to about $ 460 billion in 2008. With regard to ownership, commercial banks can be classified as public, domestic or foreign banks. The Turkish banking landscape changed after the liberalization of the market because of mergers and acquisitions, new entries and privatizations. As of 2008, there were 33 deposit-taking banks, 3 of which were state-owned banks, 17 private domestic banks and 13 foreign banks. Although the share of public banks in total assets continues to decline gradually, its impact is still high compared to EU averages. The presence of foreign banks used to be limited because of the unstable environment and entry barriers. However, the sector has recently beckoned the interest of foreign banks because of the strong growth potential and the solid economic recovery. The Turkish banking system still offers strong growth potential compared with EU countries. In the future, the environment of sustainable growth potential, relatively high margins, low inflation and declining intermediation costs are

expected to support further growth in total assets, commercial loans and deposit volumes of the banking system, leading to a long overdue process of financial deepening.

Appendix 2: Turkish political environment

Political instability accompanied with an increasing level of social disorder was the hallmark of the post-1960 military regime**.** The military coup in Turkey of 1960 was a coup d'état staged by some officers against the democratically elected government of the then Adnan Menderes-led Democratic Party. The coup occurred primarily as a response for the erosion of military and civil bureaucracy power in the Menderes era. The 1961 constitution was reoriented toward the preservation of the status-quo and sought to impose significant institutional constraints (e.g., establishment of a second parliamentary chamber and a constitutional court with powers to invalidate government policy) on the government's discretion (Tachau and Heper 1983). These constraints produced huge rigidities on the system, and are believed to be partly responsible for the political instability as governments seemed powerless to remedy (Esfahani 1996). The 1960 coup consolidated the military's hold on the country. In 1971, after the military ultimatum, under the assistance of military forces a new coalition cabinet was formed following the increasing left- and right-wing violence.

From 1980 till 1983, the legislative process was again derailed by another coup d'état as a response to political fragmentation, radical left and right doctrines, uncompromising attitudes of political parties and unstable governments. The military junta returned power to civilians with the general elections held on November 6, 1983 and the Motherland Party, or ANAP, headed by Turgut Özal, won the elections with an absolute majority, defeating the parties favored by the military caretakers. In the Özal-era the country initiated a staged transformation towards an open economy and turned away from an inward-looking import substitution strategy. From October 1991 general elections till October 2002 general elections, the various coalition governments, frequently with opposing ideologies, proved to be weak and divided. Turkey faced in the period two economic crises episodes. In the 1994 crisis, three banks were confiscated after the sharp devaluation of domestic currency due to the unsustainable domestic borrowing policy, high inflation and high level of current account and budget deficit. To avoid a systemic crisis a full blanket deposit guarantee was introduced to cover both Turkish Lira and foreign currency denominated deposits. This blanket guarantee has not been lifted until 2001 after another and much deeper economic crisis in 2000 hit the country.

The 2000/2001 crisis was a classic twin crisis, caused by growing macroeconomic imbalances. Ultimately, the government was forced to abandon the euro-dollar crawling peg it had primarily initiated to tackle high inflation and had to face the collapse of the banking system. In a reaction, the government adopted a comprehensive reform program supported by the World Bank and IMF. An important part of this program was the establishment of the Banking Regulation and

Supervision Agency (BRSA) which became more effective in prudential supervision and regulation with the appropriate enforcement power, credibility and autonomous structure in the post-crisis period. Private banks were forced to strengthen their equity capital, either independently or through mergers and acquisitions, and about 20 fragile banks that failed to comply were transferred to the State Deposit Insurance Fund. It is widely believed that the introduction of full insurance coverage on deposits fuelled an unreasonable competition between financial institutions at the expense of sound banking practices and was one of the main causes that triggered the crisis in 2000/2001 (BAT, 2009). In November 2002 Turkish voters punished the governing parties, for their economic mismanagement, and pinned their hopes on Erdogan, the leader of Justice and Development Party (AKP). Table A2 presents an overview of the parties in power after the 1960 coup d'état.

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Figure 1: Average growth curve of the number of government and private deposit accounts around the period that former cabinet member leave office.

The graphical representation of the average growth rates of the number of deposit accounts (i.e., #DEPG) around the period that former cabinet members leave office, over a seven-year window [-4, 0, +3]. We make a distinction between the growth rates of government deposit accounts (#GOVDEPG, dashed line) and other, i.e., private, deposit accounts (#PRIVDEPG, solid line). The years [-4, -1] represent the last three years that the former cabinet member is at the top of the bank; the year 0 is the event-year in which the former cabinet member leaves the bank; and the years [+1, +3] represent the three years after this person leaves the bank.

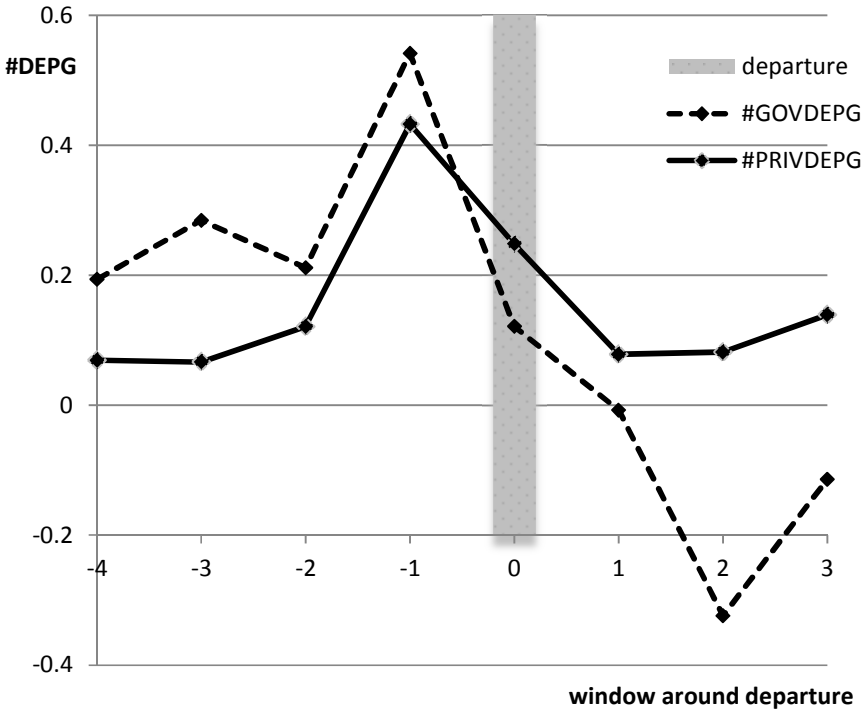

Table 1: Summary statistics

	Description	Mean	Std. Dev.
Dependent variables			
DEPG	The first difference of the log of real (expressed in 1987 prices) deposits	0.1620	0.5848
IDEP	Annual interest expenses divided by total deposits	0.2860	0.3177
Bank risk variables			
Equity	Ratio of book value of equity to total assets	0.1198	0.1267
Liquidity	Ratio of liquid assets (cash, central bank debt, and short-term securities) to total deposits	0.7018	1.0631
Bad Loans	Ratio of loans under follow-up to gross loans	0.1128	0.3205
ROA	Ratio of profit after taxes to total assets	0.0267	0.0510
Political variables			
PCON	Dummy variable which takes the value of 1 when bank's top executive was previously a member of Turkish parliament, and otherwise 0	0.0857	0.2713
MIN	Dummy variable which takes the value of 1 when a bank's top executive was formerly a cabinet or prime minister, and otherwis 0	0.0631	0.2353
GOV	Dummy variable which takes the value of 1 when the (last) party of the former politician is currently in the government, and otherwise 0	0.0452	0.2011
POLBANK	Dummy variable that equals to 1 for banks that ever hired a former politician in the sample period, and otherwise 0	0.3243	0.4682
Control variables			
Size	Natural logarithm of the book value of total assets (expressed in 1987 prices)	12.2648	2.0765
Age	The number of years the bank exists	37.4472	32.3565
Emplbr	Ratio of total number of employees to total number of branches	36.6424	141.0743
Fragment	Monthly weighted number of parties in the government in one specific year	1.8635	1.1167
Xordin	Dummy variable equals to 1 during the extraordinary military government period (1981-1983), and otherwise 0	0.0920	0.2891
Bcycle	Growth rate of real gross national product	0.0417	0.0490
Crisis	Banking crisis dummy variable, which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0	0.1508	0.3580
State-banks	Banks that are predominantly owned (> 50% of shares) by the government	0.1357	0.3426
Foreign-banks	Either branches of international operating banks, or banks predominantly owned by non-residents.	0.3386	0.4734

Table 2: Testing for the presence of depositor discipline

The estimated equations are $DEPG_{i,t} = \alpha_i + \alpha_1 \mathbf{Risk}_{i,t-1} + \alpha_2 \mathbf{Controls}_{(i),t} + \varepsilon_{i,t}$ and $IDEP_{i,t} = \beta_i + \beta_1 \mathbf{Risk}_{i,t-1} + \beta_2 \mathbf{Controls}_{(i),t} + \mu_{i,t}$. **Dependent variables:** the $DEPG$ is the first difference of the log of real (expressed in 1987 prices) deposits; the $IDEP$ is calculated as the annual interest expenses divided by total deposits. **Bank risk variables:** the $Equity$ is the ratio of book value of equity to total assets; the $Liquidity$ is the ratio of liquid assets (cash, central bank debt, and short-term securities) to total deposits; the $Bad\ loans$ is the ratio of loans under follow-up to gross loans; the ROA is the ratio of profit after taxes to total assets. To moderate the inordinate influence of extreme values, we winsorize abovementioned dependent and bank risk variables at the 2% level in both tails. **Bank controls:** the $Size$ is the natural logarithm of the book value of total assets (expressed in 1987 prices); the Age is the number of years the bank exists; the $Emplbr$ is the ratio of total number of employees to total number of branches; the $Fragment$ is the monthly weighted number of parties in the government in one specific year; the $Xordin$ is a dummy variable which takes the value of 1 during the extraordinary military government period (1981-1983), and otherwise 0; the $Bcycle$ is the growth rate of real gross national product; the $Crisis$ is a banking crisis dummy variable which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0; *State-banks are b*anks that are predominantly owned (> 50% of shares) by the government; *Foreign-banks* are either branches of international operating banks, or banks predominantly owned by non-residents. Standard errors (in parentheses) are corrected for clustering at the bank level. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels, respectively.

	Panel A					**Panel B**					
	DEPG						IDEP				
	(1)	(2)	(3)	(4)	(5)		(1)	(2)	(3)	(4)	(5)
Equity	1.9622***				1.8866***	Equity	-0.2271**				-0.3205**
	(0.280)				(0.373)		(0.109)				(0.126)
Liquidity		0.1619***			0.1335***	Liquidity		0.0645***			0.0733***
		(0.032)			(0.035)			(0.020)			(0.020)
Bad loans			0.1660***		0.0664	Bad loans			-0.0290		-0.0109
			(0.052)		(0.058)				(0.028)		(0.020)
ROA				0.7343	-0.1740	ROA				0.1965	0.1935
				(0.584)	(0.633)					(0.206)	(0.181)
Size	0.1708***	0.1214***	0.1225***	0.1029***	0.1658***	Size	0.0157	0.0261*	0.0169	0.0198	0.0118
	(0.029)	(0.025)	(0.025)	(0.026)	(0.028)		(0.016)	(0.014)	(0.018)	(0.017)	(0.016)
Age	-0.0202***	-0.0134***	-0.0133***	-0.0112***	-0.0173***	Age	-0.0059**	-0.0067***	-0.0057*	-0.0061**	-0.0043*
	(0.005)	(0.004)	(0.004)	(0.004)	(0.004)		(0.003)	(0.002)	(0.003)	(0.003)	(0.003)
Emplbr	0.0002***	0.0002***	0.0003***	0.0002***	0.0002***	Emplbr	-0.0001**	-0.0000***	-0.0001**	-0.0000**	-0.0001**
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)		(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Fragment	0.0346**	0.0129	0.0071	0.0032	0.0328**	Fragment	0.0246**	0.0310***	0.0254**	0.0276**	0.0241**
	(0.016)	(0.013)	(0.014)	(0.014)	(0.015)		(0.011)	(0.009)	(0.010)	(0.010)	(0.009)
Xordin	0.2029***	0.2207***	0.1929***	0.2085***	0.2341***	Xordin	-0.0593**	-0.0447**	-0.0516*	-0.0529**	-0.0377
	(0.060)	(0.058)	(0.055)	(0.056)	(0.057)		(0.027)	(0.022)	(0.028)	(0.026)	(0.023)
Bcycle	-0.2503	-0.0078	-0.0293	0.0158	-0.2615	Bcycle	-0.3294*	-0.3927**	-0.3521**	-0.3562**	-0.3475**
	(0.342)	(0.364)	(0.370)	(0.370)	(0.343)		(0.168)	(0.167)	(0.176)	(0.169)	(0.168)
Crisis	0.0506	-0.0024	0.0400	0.0331	0.0173	Crisis	0.0287	0.0127	0.0262	0.0296	0.0079
	(0.054)	(0.056)	(0.059)	(0.058)	(0.055)		(0.021)	(0.022)	(0.022)	(0.021)	(0.023)
State-banks	-0.5819***	-0.4765**	-0.5434***	-0.4949**	-0.5761***	State-banks	0.1715**	0.1685**	0.1730**	0.1610**	0.1883**
	(0.207)	(0.197)	(0.203)	(0.193)	(0.207)		(0.077)	(0.074)	(0.075)	(0.079)	(0.085)
Foreign-banks	-0.0543	-0.1171	-0.0671	-0.0765	-0.0940	Foreign-banks	0.1299*	0.1140*	0.1310*	0.1307*	0.1068*
	(0.087)	(0.106)	(0.097)	(0.094)	(0.101)		(0.078)	(0.064)	(0.077)	(0.077)	(0.062)
Bank-fixed effects	Yes	Yes	Yes	Yes	Yes	Bank-fixed effects	Yes	Yes	Yes	Yes	Yes
No. of observations	1,252	1,252	1,237	1,252	1,237	No. of observations	1,256	1,252	1,239	1,256	1,237
R^2	0.144	0.105	0.046	0.043	0.184	R^2	0.049	0.093	0.037	0.043	0.106

Table 3: Impact of blanket deposit guarantee and political connections on depositor discipline

Dependent variables: the $DEPG$ is the first difference of the log of real (expressed in 1987 prices) deposits; the $IDEP$ is calculated as the annual interest expenses divided by total deposits. **Bank risk variables:** the $Equity$ is the ratio of book value of equity to total assets; the $Liquidity$ is the ratio of liquid assets (cash, central bank debt, and short-term securities) to total deposits; the $Bad\ loans$ is the ratio of loans under follow-up to gross loans; the ROA is the ratio of profit after taxes to total assets. To moderate the inordinate influence of extreme values, we winsorize abovementioned dependent and bank risk variables at the 2% level in both tails. **Deposit insurance effects:** the DI takes the value of 1 for the full deposit insurance period 1994-2003, and otherwise 0. **Political connectedness effects:** the $PCON$ is equal to 1 when bank's top executive was previously a member of Turkish parliament and/or served as a cabinet member or prime minister, 0 otherwise; the MIN is a dummy variable which takes the value of 1 when a bank's top executive was formerly a cabinet member or prime minister, and 0 otherwise; the GOV variable takes the value of 1 when the affiliated party of the former politician is currently in the government, and 0 otherwise. We estimate the most flexible specification with Equity, Liquidity, Bad loans, and ROA and full set of interactions, in order to facilitate the interpretation of the results, we only report Equity and its interactions with **POL** (i.e., PCON and MIN) and DI in the discussion of our results as only Equity proved to be unambiguously leading to depositor discipline. **Bank controls:** the $Size$ is the natural logarithm of the book value of total assets (expressed in 1987 prices); the Age is the number of years the bank exists; the $Emplbr$ is the ratio of total number of employees to total number of branches; the $Fragment$ is the monthly weighted number of parties in the government in one specific year; the $Xordin$ is a dummy variable which takes the value of 1 during the extraordinary military government period (1981-1983), and otherwise 0; the $Bcycle$ is the growth rate of real gross national product; the $Crisis$ is a banking crisis dummy variable which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0; *State-banks are b*anks that are predominantly owned (> 50% of shares) by the government; *Foreign-banks* are either branches of international operating banks, or banks predominantly owned by non-residents. Standard errors (in parentheses) are corrected for clustering at the bank level. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels, respectively.

	DEPG	IDEP	DEPG	IDEP	DEPG	IDEP	DEPG	IDEP
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Equity	1.9442***	-0.4143***	1.9772***	-0.4204***	1.9741***	-0.4194***	1.9600***	-0.4226***
	(0.427)	(0.114)	(0.434)	(0.115)	(0.435)	(0.116)	(0.433)	(0.118)
Equity x DI	0.3129	0.0956	0.2817	0.1000	0.2819	0.0998	0.3438	0.1493
	(0.617)	(0.241)	(0.624)	(0.242)	(0.624)	(0.243)	(0.550)	(0.224)
Equity x PCON			-2.6785***	0.4401*	-4.8831***	0.8148***		
			(0.826)	(0.248)	(0.818)	(0.230)		
Equity x PCON x MIN					3.4645***	-0.6062*		
					(1.149)	(0.350)		
Equity x PCON x GOV							-8.3372***	2.4896***
							(0.865)	(0.359)
Equity x PCON x MIN x GOV							7.3287***	-1.9750***
							(0.812)	(0.440)
Size	0.1799***	0.0067	0.1775***	0.0067	0.1831***	0.0066	0.1830***	0.0074
	(0.028)	(0.015)	(0.028)	(0.015)	(0.028)	(0.015)	(0.028)	(0.016)
Age	-0.0213***	-0.0032	-0.0202***	-0.0030	-0.0210***	-0.0029	-0.0210***	-0.0028
	(0.004)	(0.002)	(0.004)	(0.002)	(0.004)	(0.003)	(0.004)	(0.002)
Emplbr	0.0002***	-0.0000*	0.0002***	-0.0000	0.0002***	-0.0000	0.0002***	-0.0000*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Fragment	-0.0327	0.0368***	-0.0342	0.0365***	-0.0374	0.0368***	-0.0272	0.0443***
	(0.023)	(0.013)	(0.023)	(0.013)	(0.023)	(0.013)	(0.018)	(0.010)
Xordin	0.2092***	-0.0285	0.2164***	-0.0301	0.2185***	-0.0315	0.2267***	-0.0301
	(0.055)	(0.022)	(0.056)	(0.022)	(0.057)	(0.022)	(0.057)	(0.023)
Bcycle	0.1904	-0.4655***	0.1713	-0.4716***	0.1692	-0.4707***	0.1390	-0.5024***
	(0.346)	(0.175)	(0.347)	(0.176)	(0.347)	(0.176)	(0.363)	(0.174)
Crisis	-0.0195	0.0214	-0.0227	0.0213	-0.0211	0.0218	-0.0233	0.0244
	(0.051)	(0.020)	(0.052)	(0.020)	(0.052)	(0.020)	(0.051)	(0.020)
State-banks	-0.5608***	0.1955**	-0.5424***	0.2045**	-0.5211***	0.2051**	-0.5229***	0.2026**
	(0.207)	(0.087)	(0.200)	(0.089)	(0.186)	(0.091)	(0.184)	(0.089)
Foreign-banks	-0.0248	0.0888	-0.0229	0.0902	-0.0225	0.0901	-0.0218	0.0902
	(0.106)	(0.062)	(0.107)	(0.062)	(0.107)	(0.063)	(0.108)	(0.062)
Bank-fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of observations	1,237	1,237	1,237	1,237	1,237	1,237	1,237	1,237
R^2	0.218	0.139	0.223	0.140	0.227	0.140	0.225	0.140

Table 4: Testing for depositor discipline through Heckman two-stage treatment effects

Panel A is the 1st Step of Heckman 2-step Treatment model. **Dependent variables:** the $PCON$ is equal to 1 when bank's top executive was previously a member of Turkish parliament and/or served as a cabinet member or prime minister, 0 otherwise; the MIN is a dummy variable which takes the value of 1 when a bank's top executive was formerly a cabinet member or prime minister, and 0 otherwise. **Explanatory variables** are all lagged with one year and include: the ln(#govdep + 1) is equal to the natural logarithm of the total number of government deposit accounts (#govdep); the z-score is a measure of bank stability and is calculated as $z = \frac{\text{Mean(EQ/TA+ROA)}}{\text{St.Dev.(ROA)}}$, i.e., average capitalization $\left(\frac{\text{Equity}}{\text{Total Assets}}\right)$ and return on assets (ROA) during the four preceding years over the 4-year standard deviation of the return on assets; the Liquid/TA, is defined as the ratio of liquid assets to total assets; the $Size$ is the natural logarithm of the book value of total assets (expressed in 1987 prices); the Age is the number of years the bank exists; the $Emplbr$ is the ratio of total number of employees to total number of branches; the $Fragment$ is the monthly weighted number of parties in one specific year; the $Xordin$ is a dummy variable which takes the value of 1 during the extraordinary military government period (1981-1983), and otherwise 0; the $Bcycle$ is the growth rate of real gross national product; the $Crisis$ is a banking crisis dummy variable which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0. Standard errors are in parentheses. $***$ indicates significance at the 1% level, $**$ at the 5% level, and $*$ at the 10% level. **Panel B** is the 2nd Step of Heckman 2-step Treatment model. **Dependent variables:** the $DEPG$ is the first difference of the log of real (expressed in 1987 prices) deposits; the $IDEP$ is calculated as the annual interest expenses divided by total deposits. **Bank risk variables:** the $Equity$ is the ratio of book value of equity to total assets; the $Liquidity$ is the ratio of liquid assets (cash, central bank debt, and short-term securities) to total deposits; the $Bad\ loans$ is the ratio of loans under follow-up to gross loans; the ROA is the ratio of profit after taxes to total assets. To moderate the inordinate influence of extreme values, we winsorize abovementioned dependent and bank risk variables at the 2% level in both tails. **Political connectedness effects:** the $PCON$ is equal to 1 when bank's top executive was previously a member of Turkish parliament and/or served as a cabinet member or prime minister, 0 otherwise; the MIN is a dummy variable which takes the value of 1 when a bank's top executive was formerly a cabinet member or prime minister, and 0 otherwise; the *GOV* variable takes the value of 1 when the affiliated party of the former politician is currently in the government, and 0 otherwise. We estimate the most flexible specification with Equity, Liquidity, Bad loans, and ROA and full set of interactions, in order to facilitate the interpretation of the results, we only report Equity and its interactions with **POL** (i.e., PCON and MIN) in the discussion of our results as only Equity proved to be unambiguously leading to depositor discipline. **Bank controls:** the $Size$ is the natural logarithm of the book value of total assets (expressed in 1987 prices); the Age is the number of years the bank exists; the $Emplbr$ is the ratio of total number of employees to total number of branches; the $Fragment$ is the monthly weighted number of parties in the government in one specific year; the $Xordin$ is a dummy variable which takes the value of 1 during the extraordinary military government period (1981-1983), and otherwise 0; the $Bcycle$ is the growth rate of real gross national product; the $Crisis$ is a banking crisis dummy variable which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0; *State-banks are b*anks that are predominantly owned (> 50% of shares) by the government; *Foreign-banks* are either branches of international operating banks, or banks predominantly owned by non-residents; the λ_{PCON} is the inverse of the Mill's ratio for being political connected; the λ_{MIN} is the inverse of the Mill's ratio for selecting only past cabinet members. Standard errors (in parentheses) are corrected for clustering at the bank level. $***$ indicates significance at the 1% level, $**$ at the 5% level, and $*$ at the 10% level.

Panel A: 1st Step of Heckman 2-Step Treatment Model

	PCON, t		MIN, t	
	Coef.	St. Err.	Coef.	St. Err.
ln(#govdep+1), t – 1	-0.1188	(0.077)	-0.1970*	(0.114)
z-score, t – 1	-0.0075	(0.005)	-0.0120*	(0.007)
Liquid/TA, t – 1	-2.5039***	(0.795)	-2.3431**	(1.008)
Size, t – 1	-0.2346*	(0.122)	0.0861	(0.167)
Age, t – 1	0.0061	(0.010)	-0.0118	(0.014)
Emplbr, t – 1	-0.0117	(0.011)	-0.0671***	(0.020)
Fragment, t – 1	-0.3301***	(0.108)	-0.5651***	(0.159)
Xordin, t – 1	0.4888*	(0.288)	0.6874*	(0.376)
Bcycle, t – 1	-1.6480	(2.416)	-1.3479	(3.330)
Crisis, t – 1	-0.2634	(0.297)	-0.0813	(0.385)
Constant	0.6876	(1.376)	-1.7311	(1.837)
Random-effects	Yes		Yes	
R^2	0.259		0.293	

Panel B: 2nd Step of Heckman 2-Step Treatment model

	DEPG		IDEP	
	(1)	(2)	(3)	(4)
Equity	0.9427***	0.9381***	-0.2251*	-0.2260*
	(0.338)	(0.335)	(0.127)	(0.127)
Equity x PCON	-3.8833***		0.4313*	
	(0.954)		(0.225)	
Equity x PCON x MIN	3.9631***		-0.4511	
	(1.264)		(0.476)	
Equity x PCON x GOV		-7.9430***		1.3333***
		(0.974)		(0.383)
Equity x PCON x MIN x GOV		8.4947***		-1.1700*
		(1.058)		(0.600)
Size	0.1409***	0.1408***	-0.0533***	-0.0533***
	(0.015)	(0.015)	(0.008)	(0.008)
Age	-0.0053***	-0.0054***	0.0014***	0.0014***
	(0.001)	(0.001)	(0.001)	(0.001)
Emplbr	-0.0076***	-0.0077***	0.0050***	0.0050***
	(0.002)	(0.002)	(0.001)	(0.001)
Fragment	0.0105	0.0123	0.0332***	0.0336***
	(0.013)	(0.013)	(0.008)	(0.008)
Xordin	0.2253***	0.2384***	0.0048	0.0080
	(0.045)	(0.045)	(0.021)	(0.021)
Bcycle	0.1402	0.1503	-0.5601***	-0.5614***
	(0.351)	(0.350)	(0.172)	(0.173)
Crisis	0.0382	0.0368	-0.0159	-0.0157
	(0.046)	(0.046)	(0.015)	(0.015)
State-banks	-0.2024***	-0.1984***	0.1348***	0.1355***
	(0.062)	(0.059)	(0.050)	(0.051)
Foreign-banks	-0.0950**	-0.0964**	0.0700**	0.0703**
	(0.046)	(0.046)	(0.034)	(0.034)
λ_{PCON}	-0.3169***	-0.3202***	0.1740***	0.1740***
	(0.039)	(0.039)	(0.022)	(0.022)
λ_{MIN}	0.1898***	0.1929***	-0.1046***	-0.1045***
	(0.036)	(0.036)	(0.018)	(0.018)
Random-effects	Yes	Yes	Yes	Yes
Observations	1,198	1,198	1,198	1,198
R^2	0.336	0.335	0.357	0.358

Table 5: Different slopes for politically connected banks

Dependent variables: the $DEPG$ is the first difference of the log of real (expressed in 1987 prices) deposits; the $IDEP$ is calculated as the annual interest expenses divided by total deposits. **Bank risk variables:** the $Equity$ is the ratio of book value of equity to total assets; the $Liquidity$ is the ratio of liquid assets (cash, central bank debt, and short-term securities) to total deposits; the $Bad\ loans$ is the ratio of loans under follow-up to gross loans; the ROA is the ratio of profit after taxes to total assets. To moderate the inordinate influence of extreme values, we winsorize abovementioned dependent and bank risk variables at the 2% level in both tails. **Political connectedness effects:** The $POLBANK$ variable is equal to 1 in all years for banks that ever hired a former politician in the sample period, and 0 otherwise; the $PCON$ is equal to 1 when bank's top executive was previously a member of Turkish parliament and/or served as a cabinet member or prime minister, 0 otherwise; the MIN is a dummy variable which takes the value of 1 when a bank's top executive was formerly a cabinet member or prime minister, and 0 otherwise; the GOV variable takes the value of 1 when the affiliated party of the former politician is currently in the government, and 0 otherwise. **Bank controls:** the $Size$ is the natural logarithm of the book value of total assets (expressed in 1987 prices); the Age is the number of years the bank exists; the $Emplbr$ is the ratio of total number of employees to total number of branches; the $Fragment$ is the monthly weighted number of parties in the government in one specific year; the $Xordin$ is a dummy variable which takes the value of 1 during the extraordinary military government period (1981-1983), and otherwise 0; the $Bcycle$ is the growth rate of real gross national product; the $Crisis$ is a banking crisis dummy variable which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0; *State-banks are b*anks that are predominantly owned (> 50% of shares) by the government; *Foreign-banks* are either branches of international operating banks, or banks predominantly owned by non-residents. We only report Equity and its interactions with **POL** (i.e., PCON and MIN), although we estimate the most flexible specification with Equity, Liquidity, Bad loans, and ROA and full set of interactions, in order to facilitate the interpretation of the results. The coefficients on the control variables are also not reported to simplify presentation. Standard errors (in parentheses) are corrected for clustering at the bank level. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels, respectively.

	DEPG	IDEP	DEPG	IDEP	DEPG	IDEP
	(1)	(2)	(3)	(4)	(5)	(6)
Equity	1.8483***	-0.3267**	1.8519***	-0.3269**	1.8516***	-0.3261**
	(0.398)	(0.134)	(0.399)	(0.134)	(0.399)	(0.134)
Equity x POLBANK	0.8660	0.2496	0.7825	0.2622	0.6155	0.2447
	(0.620)	(0.191)	(0.609)	(0.192)	(0.621)	(0.191)
Equity x PCON	-3.1373***	0.1115	-4.7101***	0.5517***		
	(0.779)	(0.216)	(0.530)	(0.202)		
Equity x PCON x MIN			2.7685***	-0.6623*		
			(0.777)	(0.344)		
Equity x PCON x GOV					-7.5843***	1.5253***
					(0.934)	(0.368)
Equity x PCON x MIN x GOV					6.7081***	-1.4689***
					(0.872)	(0.423)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes
Bank-fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
No. of observations	1,237	1,237	1,237	1,237	1,237	1,237
R^2	0.191	0.109	0.193	0.109	0.191	0.109

Table 6: Testing for the impact of political connections on depositor discipline for different agents

Dependent variables: the #SAVDEPG is equal to the growth in the number of savings deposits; the #FIRMDEPG is equal to the growth in the number of firm deposits; the #BANKDEPG is equal to the growth in the number of bank deposits; and the #PRIVDEPG is equal to the growth in the number of private deposits (with private deposits equal to the sum of savings deposits, firm deposits and bank deposits). **Political connectedness effects:** the $PCON$ is equal to 1 when bank's top executive was previously a member of Turkish parliament and/or served as a cabinet member or prime minister, 0 otherwise; the MIN is a dummy variable which takes the value of 1 when a bank's top executive was formerly a cabinet member or prime minister, and 0 otherwise. **Bank controls:** the $Size$ is the natural logarithm of the book value of total assets (expressed in 1987 prices); the Age is the number of years the bank exists; the $Emplbr$ is the ratio of total number of employees to total number of branches; the $Fragment$ is the monthly weighted number of parties in the government in one specific year; the $Xordin$ is a dummy variable which takes the value of 1 during the extraordinary military government period (1981-1983), and otherwise 0; the $Bcycle$ is the growth rate of real gross national product; the $Crisis$ is a banking crisis dummy variable which takes the value of 1 in 1982, 1991, 1994, and 2000, and otherwise 0; *State-banks are b*anks that are predominantly owned (> 50% of shares) by the government; *Foreign-banks* are either branches of international operating banks, or banks predominantly owned by non-residents. We only report Equity and its interactions with **POL** (i.e., PCON and MIN), although we estimate the most flexible specification with Equity, Liquidity, Bad loans, and ROA and full set of interactions, in order to facilitate the interpretation of the results. The coefficients on the control variables are also not reported to simplify presentation. Standard errors (in parentheses) are corrected for clustering at the bank level. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels, respectively.

	# PRIVDEPG	# SAVDEPG	# FIRMDEPG	# BANKDEPG
	(1)	(2)	(3)	(3)
Equity	1.1376***	0.9815***	1.0341***	1.1753***
	(0.191)	(0.271)	(0.228)	(0.428)
Equity x PCON	-3.5403*	-4.4386	-3.2160**	-1.1226
	(2.101)	(3.083)	(1.555)	(3.346)
Equity x PCON x MIN	4.6179**	5.7076*	3.9239**	-0.1860
	(2.216)	(3.150)	(1.969)	(3.661)
Control variables	Yes	Yes	Yes	Yes
Bank-fixed effects	Yes	Yes	Yes	Yes
Observations	1,231	1,157	1,222	1,138
R-squared	0.102	0.062	0.060	0.028

Table A1: Overview of the Turkish banking system

	public share (%)	commercial share (%)	foreign share (%)	average number of branches	average number of employees	assets/GNP (%)
1963	64.4	28.9	4.3	35.8	668.8	16.1
1970	49.6	29.5	3.0	69.4	1434.1	18.3
1980	44.1	44.2	2.9	138.5	2914.2	31.4
1981	42.5	47.2	2.9	138.8	2812.5	37.2
1982	41.8	47.3	3.2	132.4	2737.4	41.7
1983	47.0	42.2	3.7	139.6	2965.7	45.2
1984	47.8	41.6	4.1	132.0	2865.0	45.3
1985	47.6	43.6	3.6	125.4	2764.0	43.9
1986	43.1	45.3	3.8	115.4	2606.8	49.4
1987	44.2	44.9	3.1	114.6	2660.6	55.1
1988	43.1	43.8	3.6	108.8	2521.0	52.9
1989	45.4	42.3	3.1	106.3	2468.8	47.3
1990	44.6	43.2	3.5	99.4	2334.7	42.9
1991	42.3	45.8	3.3	99.6	2352.3	46.6
1992	43.1	46.0	3.7	89.9	2127.9	50.2
1993	36.9	52.3	3.8	89.2	2056.9	52.5
1994	39.5	49.3	3.0	91.1	2075.3	52.0
1995	37.7	52.0	2.9	91.8	2129.3	52.2
1996	38.3	52.7	3.0	93.4	2147.1	59.8
1997	34.6	55.4	4.7	94.7	2150.9	65.9
1998	34.9	53.3	4.4	98.3	2219.9	68.8
1999	34.9	49.5	5.2	95.0	2148.0	92.1
2000	34.3	47.5	5.4	99.2	2157.0	82.9
2001	32.4	56.3	3.0	113.2	2254.0	94.3
2002	31.9	56.2	3.1	113.1	2282.8	77.3
2003	33.3	57.0	2.8	119.3	2465.0	70.0
2004	34.9	57.4	3.4	127.2	2649.2	71.4
2005	31.4	59.7	5.2	132.9	2814.0	81.6
2006	29.6	54.8	12.2	148.9	3111.8	84.2
2007	29.2	52.3	15.0	165.6	3446.4	86.5
2008	30.4	54.1	14.8	195.3	3813.3	87.1

Table A2: Post 1960 elections and governments in Turkey

Date of the elections	Duration of the government	Parties in the government
15.10.1961	30.05.1960 - 28.10.1961	Military intervention
	20.11.1961 - 01.06.1962	CHP + AP
	25.06.1962 - 02.12.1963	CHP+YTP+CKMP+BG
	25.12.1963 - 13.02.1965	CHP+Indep.
10.10.1965	20.02.1965 - 22.10.1965	AP+CKMP+MP+YTP
	27.10.1965 - 27.10.1969	AP+CKMP+MP+YTP
12.10.1969	03.11.1969 - 14.02.1970	AP
	06.03.1970 - 12.03.1971	AP
	26.03.1971 - 03.12.1971	Extraordinary
	11.12.1971 - 17.04.1972	Extraordinary
	22.05.1972 - 10.04.1973	Extraordinary
14.10.1973	15.04.1973 - 16.12.1973	AP+CGP
	26.01.1974 - 16.09.1974	CHP+MSP
	16.11.1974 - 31.03.1975	Temporary (N)
05.06.1977	31.03.1975 - 21.06.1977	AP+MSP+MHP+CGP
	21.06.1977 - 03.07.1977	CHP(N)
	21.07.1977 - 31.12.1977	AP+MSP+MHP
	05.01.1978 - 17.10.1979	CHP+BG+CGP+DP
	12.11.1979 - 12.09.1980	AP(minority)
	22.09.1980 - 24.11.1983	Military intervention
06.11.1983	13.12.1983 - 21.12.1987	ANAP
29.11.1987	21.12.1987 - 09.11.1989	ANAP
	09.11.1989 - 23.06.1991	ANAP
	23.06.1991 - 20.11.1991	ANAP
20.10.1991	21.11.1991 - 25.06.1993	DYP+SHP
	25.06.1993 - 05.10.1995	DYP+SHP/CHP
	05.10.1995 - 30.10.1995	DYP+SHP/CHP
24.12.1995	30.10.1995 - 06.03.1996	DYP+SHP/CHP
	06.03.1996 - 28.06.1996	ANAP+DYP
	28.06.1996 - 30.06.1997	RP+DYP
	30.06.1997 - 11.01.1999	DSP+ANAP+DTP
18.04.1999	11.01.1999 - 28.05.1999	DSP(Minority)
	28.05.1999 - 04.11.2002	DSP+MHP+ANAP
03.11.2002	18.11.2002 - 14.03.2003	AKP
	14.03.2003 - 29.08.2007	AKP
22.07.2007	29.08.2007 -	AKP