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Research Paper

Fines versus prison for the issuance of bad checks: Evidence from a policy shift in Turkey☆

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ABSTRACT

We investigate whether the February 2012 amendments to the Check Law in Turkey that replaced imprisonment with administrative fines for issuing bad checks were a driver of the surge in bad checks since late 2011. As the change in the law was foreseen, we argue that check issuance behavior was altered before the new law became official. To capture this, we use the cumulative volume of internet search queries related to the upcoming legal change. We find that, unlike the case during the global financial crisis of 2008–09, the surge in bad checks occurring in 2011–12 cannot be accounted for by the state of the economic environment unless the effects of the February 2012 law change are also controlled for. We also provide evidence that economic agents adjust fairly rapidly to the legal change, which reverses the surge in bad checks within a year. Overall, our findings suggest that sanctions need not be harsh to deter non-violent offenses provided that appropriate institutional structures are in place.

1. Introduction

The economic approach to criminal law posits that criminals are not necessarily different from other people, they simply face different expected costs and benefits of committing a crime and engage in the criminal activity if the expected benefits outweigh the expected costs (Becker, 1968). The primary role of criminal sanctions is thus not to punish wrongdoers for past behavior but to provide appropriate incentives for rational, forward-looking individuals to behave in a socially desirable manner in the future. Designing appropriate sanctions is a crucial objective of the criminal justice system under this view and involves difficult decisions regarding the form as well as the severity and certainty of the punishments imposed. The theory suggests that monetary sanctions should generally be preferred to non-monetary sanctions such as imprisonment (e.g.

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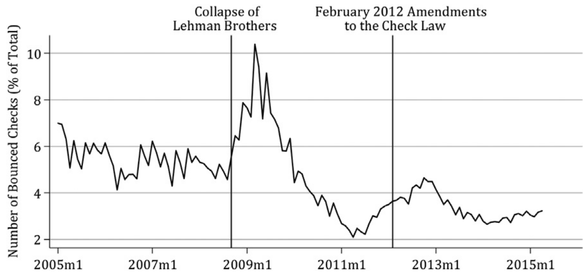

Fig. 1. Fraction of bad check counts. This figure displays the ratio of the number of bad (bounced) checks to the number of all checks during January 2005–March 2015.

Polinsky and Shavell, 2007) and, given the form of the sanction, and ceteris paribus, an increase in the expected punishment will reduce individuals' propensity to engage in the wrongful act (general deterrence).[1]

In this paper, we provide a test of general deterrence by exploiting a shift in the law governing the usage of checks in Turkey. In particular, we investigate whether the February 2012 amendments to the Turkish Check Law was a driver of the surge in the incidence of bad checks that occurred with similar timing. Prior to 2012, the act of issuing a bad check could and often did result in imprisonment, the duration of which depended on the value of the unpaid check. The amendments to the check law replaced prison sentence with civil sanctions such as restrictions on the opening of check accounts and the issuing of checks for several years. This change implied a substantial reduction in the severity of punishment for issuing bad checks. We conjecture that this unprecedented change might have induced some check issuers to renege on their commitments, thereby leading to the observed rise in the incidence of bad checks.

Investigating the impact of the February 2012 change in the laws governing the use of checks in Turkey is interesting for at least two practical reasons. First, the change represents a rare example of a shift in legal punishment regime from imprisonment to fines for a non-violent offense. Such shifts in punishment regime (especially for drug charges and failing to pay court fees) have been of particular policy relevance in the United States recently,[2] and there is not much information in the literature about the impacts of such regime shifts. Second, investigating the 2012 shift is important from a financial stability perspective as well because checks have historically been the most widely used financial instrument within the Turkish commercial sector, particularly among privately-held small- and medium-sized enterprises (which constitute 99.8 percent of all firms). On average, about 20 million checks worth 30 percent of annual domestic output are issued each year in Turkey and they are almost exclusively used within the commercial sector of the economy.[3] This feature of check usage in Turkey contrasts with the practices in many other countries where checks are used primarily by consumers in various market transactions. What's more, checks are typically post-dated in Turkey, meaning that they serve not only as a means of payment but also as a credit instrument. Accordingly, a significant change in laws governing the use of checks such as the one that occurred in February 2012 might have important implications for the health and stability of the business sector in the Turkish economy.

Our data on checks comes from the Interbank Check Clearing House of Turkey and is available at monthly frequency between January 2005 and March 2015. Fig. 1 shows that during our sample period there have been two instances where the fraction of bad check *counts* (i.e. the number of bad checks divided by the total number of checks) surges. Fig. 2 shows a similar time series pattern in the fraction of bad check *values* (i.e. the value of bad checks divided by the total value of checks). The first surge in the frequency of bad checks starts in September 2008 and reaches a peak in March 2009 (raising the fraction of bad checks from 5.5% to 10.4%) whereas the second begins in July 2011 and reaches a peak in October 2012 (raising the fraction of bad checks from 2.2% to 4.7%).[4] In terms of timing, while the former surge in bad checks coincides with the global financial crisis of 2008-09, the latter coincides with the European debt crisis of 2011, events both of which impacted on the Turkish economy. It is thus tempting to explain the two surges in the frequency of bad checks with the global financial crisis and the European debt crisis, respectively. However, another important change that took place with similar timing to the second surge was the passage of the February 2012 check law that decriminalized the issuance of bad checks.

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[1] See Harel (2012) and Fisher (2014) for reviews of the literature on the economic analysis of criminal law.

[2] See, for example, the blog post by Stamm and Cockburn (2013) at https://www.aclu.org/blog/reducing-our-reliance-incarceration-look-promising-state-level-reforms-2013, where they report the broad, state level, movements in the US to reduce incarceration for non-violent offenses such as drug possession and use, petty theft, and prostitution.

[3] For example, according to the Interbank Check Clearing House of Turkey data, nearly 18.5 million checks worth 600 billion Turkish Liras (about 275 billion US dollars) were issued in 2014. This corresponds to roughly 34 percent of Turkish Gross Domestic Product in 2014, which was 1.75 trillion Turkish Liras (about 800 billion US dollars).

[4] In terms of levels, in September 2008, a total of 2,092,096 checks (worth 17.5 billion US dollars) were presented to banks for redemption, 115,984 of which (worth 0.86 billion US dollars) bounced according to the Interbank Check Clearing House of Turkey data. In March 2009, a total of 2,291,917 checks (worth 13.4 billion US dollars) were presented to banks for redemption, 238,306 of which (worth 1.4 billion US dollars) bounced. In July 2011, a total of 1,135,324 checks (worth 12.9 billion US dollars) were presented to banks for redemption, 25,224 of which (worth 0.3 billion US dollars) bounced. In October 2012, a total of 2,220,199 checks (worth 21 billion US dollars) were presented to banks for redemption, 103,192 of which (worth 1.2 billion US dollars) bounced.