ERC/METU INTERNATIONAL CONFERENCE IN ECONOMICS VI

September 11-14, 2002, Ankara, Turkey

TURKISH
Vs
MEXICAN EXPERIENCE
With
PRIVATISATION

By

İsmail BAKAN

Department of Management

Kahramanmaraş Sütçü İmam University

İsmail Hakkı ERASLAN

Mehmet SARAÇ

Department of Management

Boğaziçi University

EXECUTIVE SUMMARY

Turkey experienced impressive progress in terms of privatization policy somehow. The government of Turkey is very keen on this policy as a result of 'transition to strong economy'. The pace of privatization is also steadily accelerating in Turkey. However, especially uneven political decisions, inconsistent economic structure and successive financial crisis, insufficient legal infrastructure, and opposition from interest groups have stumbled and hindered the privatization progress of Turkey for a long time. As a result of these, Turkey has not taken necessary progress, and enough steps for this crucial issue.

As for the Mexican case, her experiment of hyper-privatization demonstrates how a semi-authoritarian political system is influential in implementing comprehensive and systematic privatization program over a short space of time. Unlike other developing countries, Mexico experienced a gradual approach to privatization. For instance, enterprises were promoted, the social and private sectors were encouraged to participate, and the public was made aware of the importance and urgency of the process. Legal and regulatory frameworks were established to achieve transparency in each stage of privatization.

The main target of this paper is to describe and analyse the privatization process conducted in Turkey from a comparative perspective to address the question why some countries, particularly Mexico, performed rapid and successful privatization programme while others have been slower to adopt this tranformation progress, as in the case of Turkey.

For this purpose, the paper gives the general description about privatization and its principles, and the common objectives of privatization concept. After that, the paper of titles consists of sectoral distribution of privatization, namely: infrastructure, financial sector, primary sector, and manufacturing. Then, the paper analyses the structural adjustment policies and privatization process in Turkey during the last two decades. The study also demonstrates the international context that played a critical role in pattering the particular direction and depth of adjustment policies. The case of Mexico shows similarities to Turkish case but the concluding remarks reveals many differences between two countries, and demonstrates a perfect pattern for developing countries.

INTRODUCTION

The role of the state in the national economy has been discussed since the birth of capitalism. In essence, the intervention of the state in the national economy as existed at every stage of the capitalist era. However, state intervention has taken different forms during this era. In other words, it developed from mercantilism in the 16th and 17th centuries to the so-called free market economy today.

The privatization polices have first been adopted by the developed countries. Especially the experience of the UK in the implementation of large-scale privatization programs has substantially influenced the introduction of similar programs in developing countries and the questioning of the dominant position of the public sector in those countries such as Turkey and Mexico (ANDIMA, 1995).

Starr (1987) sees the privatization as a fuzzy concept that evokes sharp political reactions. It covers a great range of ideas and policies, varying from the eminently reasonable to the wildly impractical. It is also a dynamic phenomenon, and changes in ownership arrangements require explanations based upon changes in background variables (Yarrow, 1999: 157).

Privatization is the strategy or the process, which transfers totally or partially, an asset or enterprise that is owned or controlled, either directly or indirectly, by the state to private organizations. Privatization provides an opportunity to educate market capitalism, to build institutions and to reinforce democracy. It is a process of empowerment that makes people economic and political participants by creating opportunities for ownership and a sense of involvement in the society at large.

The main philosophy of the privatization is to confine the role of state in the economy in areas like health, basic education, social security, national defense, large scale infrastructure investments; provide legal and structural environment for free enterprise to operate and thus to increase the productivity and the value added to the economy by ensuring more efficient organization and management in the enterprises that should be commercialized to be competitive in the market. Harik (1992) notifies that privatization is a policy process

whereby a government reduces its role as an owner and manager of business enterprises in the interest of other actors such as individuals or corporation.

Turkey in Brief

The East-West expansion of the world's geographical horizons has ushered in a new era for a country situated in the fertile crescent and cradle of civilization called Turkey. Turkey is a historical gateway from the ancient Silk Road to new markets becoming a powerful focal point as a cultural and a political intermediary as well as a trade center of growing importance.

Turkey is stable democratic secular parliamentary Republic with proven commitments to international cooperation and is a member of major international organizations such as the UN, NATO, IMF/World Bank, the OECD, the European Council, the ECO and the OIC. Turkey has also played a pioneering role in establishing the Black Sea Economic Cooperation Council (BSCE) and upholds agreements with the International Center for Settlement of Investment Disputes (ICSID) and the Multi-National Investment Guarantee Agency (MIGA). Turkey is a fast growing and dynamic country listed as having one of the highest growth rates among OECD countries (5.5% per year) from 1984 to 1993. A more updated time frame from 1988 to 1995 still places Turkey's average growth rate over the average rate of developing countries.

Turkey provides access to a wide range of markets. Nearly half of its exports are now directed towards the European Union. Turkey also enjoys excellent relations with the Commonwealth of Independent States (CIS), Central and Eastern European Countries, the Turkish speaking Republics of Central Asia, the Gulf and the Middle East and also all Islamic countries making it a perfect base from which to access and serve these markets. Being strategically positioned at the crossroads of Europe, the Middle East, the Black Sea region and the Turkish speaking Republics of Central Asia, Turkey offers an excellent base for economic activities throughout the region. The business environment in Turkey is becoming an increasingly attractive and substantial platform for free enterprise. The Liberal Foreign Investment Law, free trade policies, a dynamic stock exchange and numerous incentives for investors and exporters all contribute to Turkey's expansion in this area. As of the end of 1995 the population of Turkey was more than 63 million, and its total land area is 814,578 square kms.

THE MAIN OBJECTIVES OF PRIVATIZATION

The privatization of the State Owned Enterprises (SOEs) has been oriented towards some concrete aims that can be generally divided into three different categories.

Economic Objectives

While privatization aims to minimize the state's involvement in industrial and commercial economic activities, to establish a free market economy, to relieve the financial burden of the SOEs from the national budget, to improve capital markets and to incorporate idle savings back into the economy, it further targets to ensure efficient allocation of resources for infrastructural investments. The primary goal of privatization is to ensure extracting the state from all economic business enterprises. However, it is not possible to consider a healthy economic progress, especially in Turkey, before the stock and capital markets are fully evolved. Capital markets must fist mature for organizations to have an access to shares, bonds or bill issues as resources without being linked up to the banking sector, as well as being able to establish a balance between the cost of the resource and the level of inflation. From this perspective, the main economic objective of the privatization can be regarded as the generation of new resources through re-directing domestic and foreign funds to financial and capital markets, while alleviating the adverse pressure place on financial markets resulting from the high level of public demand of funds.

Social Objectives

Bringing about a more equitable distribution of income, thereby giving the population a greater stake in the economic and political stability of the nation.

Political Objectives

The political aims of privatization are to bring about a change in commercial psychology and to prevent a resurgence of left-wing agitation. Put another way, the private entrepreneurs attached great importance to the transfer of state ownership into private hands, leading to a widening of private capital ownership again giving a larger proportion of the population a stake in their own livelihoods. Privatization seems to be an effective means of achieving this.

SECTORAL DISTRIBUTION OF PRIVATIZATION

The regions differ substantially with respect to the sectoral distribution of privatizations, reflecting the varying degrees of public sector involvement. Infrastructure sales, including sales in telecommunication, energy, water supply, and transportation companies, were significant in Latin America and the Caribbean as well as in East Asia and the Pacific. The other regions primarily privatized manufacturing and primary sector enterprises. In Eastern Europe and Central Asia, sales of industrial enterprises accounted for half of all sales during the period. Sales of industrial SOEs dominated privatization in the developing world in terms of number of transactions. With respect to sales revenues, however, infrastructure was the leader, accounting for 32 billion USD, or one-third of all revenues from privatization during 1988-93. Sales of industrial enterprises provided 27 percent of total sales revenues, mainly because of the sale of particularly large entities in East Asia and Latin America as well as a large number of medium-sized enterprises in Eastern Europe[1].

Infrastructure

Many development economists hope that the privatization of infrastructure services will have a positive impact on economic development. Activities such as energy generation and distribution, water sanitation, transportation, and telecommunications help shape the investment climate to determine business opportunities in the rest of the economy. Developing country governments recognized the need for such infrastructure services early on, and typically attempted to provide them by creating SOEs.

In most cases, however, these enterprises became highly inefficient. Lack of investment and failure to upgrade facilities often transformed these sectors into bottlenecks instead of producers of multiplier effects with positive externalities. East Asian countries were surprisingly weak in telecommunications sales. Only small minority shareholdings were sold in Korea Telecom, Syarikat Telekom Malaysia, and Eastern Visayas Telephone of the Philippines. Countries in other regions achieved no significant privatization in telecommunication sector until end-1993. Privatization in energy generation, transmission, and distribution also were significant overall with sales worth 9.6 billion USD in the developing world as a whole during 1988-93. The most important privatizer in this area was Argentina, which sold its electric power utilities for 2.1 billion USD and its gas distribution network for another 1.8 billion USD. Korea, Malaysia, and Philippines also privatized some of their power utilities. The most significant privatizations in transportation were sales of national airlines, which generated 5.4 billion USD, or 80 percent of all revenue from transportation privatizations.

Financial Sector

During 1988-93, sales of publicly held financial institutions amounted of almost 20 billion USD, or 20 percent of total developing country revenues from privatization. The largest share of these revenues came from privatization of commercial banks in Latin America, especially Mexico. That country embarked upon privatization of its banking sector during 1991 and 1992, and obtained 12.1 billion USD from the sell-off of eighteen commercial banks.

Primary Sector

In the early stages of development, many governments became heavily involved in the primary sector. Trading of natural resources, such as minerals or petroleum, was often the only easy way of earning foreign exchange. Privatization of primary sector activities therefore has a strong signaling effect, indicating to private investors the sincerity and intensity with which a government is pursuing privatization. Petroleum companies in particular often symbolize national wealth and independence, and most governments have therefore not dared to touch them. Hence, when Argentina began to sell drilling areas in 1990 and finally privatized YPF in 1993, the

[1] Source: Foreing Investment Advisory Service (FIAS).

international markets took this as a clear signal that the country was now open to private investment. Argentina received 4.3 billion USD from petroleum-related sales between 1990 and 1993. In Mexico, constitutional restrictions do not permit privatization of basic petroleum operations, but the government did begin to sell various downstream operations. The country also sold eleven mining companies; including its largest copper mine, Cananea, for 475 million between 1989 and 1993. Peru also engaged in substantial mining privatizations, including Hierro Peru, sold to the Chinese Shougang Group for 120 million USD.

Manufacturing

In manufacturing, Latin American countries produced the highest sales volume, even though privatizations in Eastern Europe were concentrated in this sector. Privatizations of large industrial enterprises, such as chemical and petrochemical companies and steel plants, in Argentina, Brazil, and Mexico resulted in revenues of almost 10 billion USD during 1988-93.

THE PRIVATIZATION PROGRESS OF TURKEY

From Argentina to Zaire, free market principles have been extolled as the primary means of achieving sustainable economic development. The free market development model has been enshrined in the 1980s by the multilateral lending agencies and the industrialized nations, the United States in particular. On January 24, 1980, Turkey reversed a longstanding policy of extensive state intervention in the economy and launched a concerted effort to open its economy more fully to the dictates of the marketplace. In the nine years since, Turkey's economy has undergone dramatic changes. Prior to 1980, Turkey's economy was characterized by a heavy reliance on state intervention. The fundamental transformation of Turkey's economy has moved the country from an inward-focused, import substitution-based development model toward export led growth and industrialization. In the 1930s Mustafa Kemal Ataturk, founder of the Turkish republic, institutionalized a policy called etatism: government intervention in the economy to achieve rapid industrialization. As in most developing countries, the state intervened because Turkey lacked a well-established, indigenous business class capable of leading the development process. Import substitution, adhered to from the early 1960s until 1977, was intended to eliminate undue reliance on foreign credit by domestically producing goods which previously had been imported. In true Kemalist form, the government was responsible for the direction of specific programs. This system was inherently insular in that it sought to protect domestic markets from imported goods in order to curtail the outflow of the precious capital so necessary for economic development. The 'January 24' plan, penned by then finance minister and current prime minister Turgut Ozal, reversed this inward looking perspective and switched to a more open, outward looking approach, thereby shifting the whole focus of the Turkish economy. Ozal's policies include liberalizing foreign trade, streamlining and privatizing state run industries, devaluing the currency, removing price controls and reducing the budget deficit by eliminating government largesse in state run businesses. Turkey's free market policies have been greeted in the West with great enthusiasm. The optimism of the United States and the International Monetary Fund (IMF), however, overlooks the problems Turkey is encountering as a result of its structural adjustment program. Turkey is representative of much of what is wrong with an over-reliance on free market principles. Certain elements of this program have been fully implemented while others have either been delayed or only partially implemented. For example, Ozal has succeeded in opening Turkey's financial system so that the economy is responsive to the international marketplace as well as liberalizing the foreign investment policies. He has not made as much headway in reducing inflation or eliminating the large public sector, however. The tensions between Ataturk's legacy of paternalism and Ozal's free market ideology have limited the speed and extent to which Turkey's economy can be altered. And the competition between these two economic ideologies largely defines Turkey's economic structure. The debt and economic policy When Turgut Ozal became prime minister in November 1983, he moved rapidly to restructure the economy in the hope of attracting capital. In the six years of his rule, the economy has grown an average of 5.6 percent annually. This impressive growth rate has enabled Ozal and the multilateral lending agencies to hail Turkey's economic turnaround, and hence structural adjustment, as a grand success. There are flaws in this analysis, however. Turkey's export-led industrialization has, as intended, further integrated the country into the international capitalist economy. But Turkey has paid a price in the loss of its economic sovereignty and domestic harmony. Turkey's pursuit of free market development has resulted in the quadrupling of its debt in the last 10 years, from $11 billion in 1979 to almost $45 billion in 1989. Though not quite on the scale of her Latin American counterparts, Turkey's nearly $45 billion debt has forced the country to relinquish an inordinate amount of economic control to multilateral and international lending agencies. Like other debtor countries, Turkey has traded the possibility of sustainable growth in the future for immediate access to capital. Despite the Ozalist onslaught, Turkey's economy remains an amalgam of its etatist past and its free market present. The mixed acceptance of Ozal's policies shows the tenacity of the Kemalist legacy and the

limitations on further privatization of the economy. Turkey presents a particularly interesting and complex case because of its level of development and the path it has chosen. For Turkey the dilemma is, how to establish sustainable growth without repression and what role should the state play in achieving that goal. Turkey's State Economic Enterprises (SEEs) are a major target of Ozal's privatization campaign. According to Ozalist precepts, they stand out as remnants of a bygone era, inefficient sponges soaking up far too much capital. Despite this view Ozal has moved cautiously. For example, SEEs still comprise about half of the country's economic activity and employ about 30 percent of all non-agricultural workers. The SEEs are prominent in manufacturing and other industrial areas. Some of the largest SEEs are: Petkim, which deals with petroleum and other energy products; Sumerbank, which is Turkey's largest textiles company; Turkish airlines; Teletas, the telephone system; and the cement industry. Ozal has streamlined the SEEs in an effort to make them more efficient. He has allowed the SEEs to set prices more in keeping with market forces. Ozal has also decentralized control. All of this is a prelude to the eventual privatization of many of the SEEs. Streamlining might look good on paper, but in a country with 15 to 20 percent unemployment, much of it structural, the SEEs are a major source of employment. As the SEEs are made more efficient and thus employ less people, fewer Turks will have access to the management training ground that the SEEs have traditionally provided. Moreover, in a country where unemployment and underemployment are chronically extremely high, SEEs provide many thousands of jobs that can hardly be sacrificed on the altar of productivity and profitability. Finally, since the level of social welfare expenditures and services is already far below that of industrialized countries, curbing them further would give rise to cruel consequences which are not hard to imagine. Although none of the SEEs have actually been sold off, the government's privatization plans have already met with resistance from many who fear that privatization will result in extensive denationalization (Gold, 1989)

As a result, Turkey applied closed economy till 1980s. After this date, Turkish government commenced strong and structural economic programme. The eminent January 24 decisions gave the new horizon to Turkish economy. Turkey embraced export-led strategy for her economical development, and experienced a relatively high growth rate of gross domestic product, a healthy balance of payments situation, and relatively low inflation. It may be said that, although incipient, the privatization process started around two decades ago, during the administration of Turgut Özal.

The new government believed that the state should not engage in commercial activities where the private sector could move efficiently. The state's role should ideally be confined to developing an infrastructure, primarily in energy, transportation, and telecommunications, while maintaining responsibility in public sector areas such as education, health care, and national defense. The government envisioned the privatization of the SOEs as an important part of the shrinking of the state sector in relation to the private sector. This view reflects an important policy shift in Turkey where the state took an active part in the industrialization efforts of the country by founding major enterprises in all areas of economic activity since her foundation as a modern and secular republic in 1923 (Gültekin, 1993:51).

The results of the privatization program were initially modest that a large-scale implementation of privatization in Turkey was constrained because of the presence of chronic inflation, high interest rates and mounting internal and external debts (Karataş, 1992). The program, especially, accelerated after the 1990s.

Liberalization should be regarded as a problem of designing an economic mechanism and finding the most appropriate transition period for the economy. Accelerated by the liberalization movements of the 1990s, a continuous modification and diversification process took place in the entire economy and it was widely reflected by the reforms made in the financial system. Privatization program also developed rapidly through the financial liberalization process. However, major privatization program has not performed well like other developing countries, and realized some 2.3 billion USD between 1985 and 1994.

It is interesting to observe that privatization has finally gathered momentum during 2000. Two major cases were involved, namely TÜPRAŞ (engaged in petroleum refining) and POAŞ (state oil distribution company). Shares of TÜPRAŞ were sold through domestic and international public offerings. The POAŞ deal, completed after the second attempt, constituted the pioneering case of large-scale privatization in Turkey. It is most likely that the ambitious privatization goals of the government will be fulfilled. One possible explanation of this trend involves the strengthening of executive authority. The current coalition government in Turkey, at least for the time being, does no longer seem to be associated with instability or conflict as has previously been the case. A more stable pattern of coalition politics, in turn, resulted in greater stability in the Privatization Administration itself. Another favorable sign in this respect is that after significant delay, the legal and institutional infrastructure of privatization has largely been established by the late 1990s, a factor which also helped to undermine the power

of the étatist lobby as a major source of opposition to the privatization program. A closer inspection reveals, however, that there were more fundamental factors at work which helped to accelerate the pace of the privatization program. The combination of the "depth of crises" and "favorable international context" arguments become particularly relevant for Turkey by the end of the 1990s. Endemic fiscal disequilibrium, a perennial problem in Turkey, had almost reached crisis proportions by the end of the decade. Indeed, the current government had to speed up the privatization process not because of profound ideological convictions than the previous governments, but because of deteriorating economic conditions. The mobilization of support of the international economic agencies could only be feasible through a rigorous implementation of the privatization program as part of a broader economic package. One should add that the announcement of Turkey's candidacy for full EU membership at the Helsinki Summit of December 1999 also represented a favorable push in this context. In retrospect, neither the government nor the bureaucracy had become significantly stronger than before. In a way reminiscent of the pioneering reform program of 24 January 1980, during which a major set of economic actions were taken under strong external pressure, by the weak minority government of the time, the privatization program has started to pick up speed because the government felt obliged to accept recommendations of the international community in order to avoid an impending economic disaster. An interesting issue for future research concerns a critical assessment of the private sector in the privatization process. Particularly striking in this context are the greater involvement of certain segments of the business community in the privatization process and the changing nature of private sector's relations with the state, questions, which certainly deserve further investigation (Ercan, 2001: 109-34).

Objectives of Privatization from Turkish Perspective

As part of the reaction to the 1994 currency crisis, the legal-institutional framework of privatization has been substantially strengthened (Celasun, and Arslan, 2001:249). The turning point in Turkish privatization experience can be considered as the passage of the Privatization Law in 1994, which managed to overcome the legal framework's previous deficiencies. In doing so, the administrative procedures especially decision-making process gained much more efficiency.

The Government decided to further sped up the pace of privatization with a new Privatization Law containing the following objectives:

- To expand the scope of assets to be privatized
- To provide an adequate framework/funds/mechanism to speed up Privatization and restructuring of SOEs
- To protect the free market from anti-competitive mechanisms, in the event of dominant companies being privatized
- To established a social safety net for employees who lose their jobs as a result of privatization
- To establish a special Privatization High Council and Privatization Administration

In addition to these, multitudes of objective have been identified for the Turkish privatization program. However, given the presence of large budget deficits and the underlying fiscal crisis of the state, the emphasis has been unambiguously placed on the goal of revenue maximization.

The emphasis on fiscal gains has also been implicit in the most recent case involving the sale of public stake in İşbank in 1998 and partial sale of Tüpraş in 2000 while the overt objective had been announced as widening of share ownership in the spirit of popular capitalism.

Indeed, it is fair to say that the fundamental objective normally associated with privatization programs-an improvement in efficiency and the creation of a more competitive environment-have largely been downplayed or de-emphasized in the Turkish context.

Promotion of Competition and Improvement of Efficiency

In Turkey, some SOEs still have monopoly in the domestic market, although the abolition of some legal monopolies on tradable goods has occurred since the mid-1980s, such as tea production and fertilizer distribution, tobacco and hard liquors. Another sample is MKEK.

Several SOEs are also the predominant domestic producers in such sectors as non-ferrous metals, newsprint, paper, sugar, petrochemicals, and bulk chemicals. A large number of SOEs are concerned with provision of non-

tradable services and hold a monopoly situation in these areas. They include post and telecommunications, railways, air transport, air and seaport administration, and until recently electricity distribution.

However, competition is an important mechanism for the maximization of the consumer surplus. It is therefore necessary to take measures that encourage the development of a competitive environment to erode the SOEs' current monopolistic position. In order to reliever this situation, the following measures may be adopted:

- The monopoly may be broken up
- Monopoly advantages can be reduced through the formation of competing firms
- The monopoly may be diminished by encouraging foreign capital into these markets
- Encouragement of share ownership through the discount pricing of SOEs shares
- The SOEs may also be privatized ad regulated by an independent agency

As a result, it can be said that privatization of public monopolies would simply mean the transformation of state monopolies into private monopolies without creating conditions for competition in the market. SOEs must therefore restructure for competitive market conditions where this is feasible.

The argument that privatization would increase the efficiency of SOEs is more economic than political. It may therefore be possible to increase the efficiency of SOEs through meaningful restructuring without the need to transfer them to the private sector. However, governments have real political disincentives to implement painful restructuring on the scale required.

Privatization Revenues and Their Impact on Reducing the Public Debt

Although provision of revenue for the state ranks as the last goal of privatization according to the Morgan Bank Master Plan, it has been observed with passing time that this goal has become the most important one because privatization revenue offer large sums of instant cash without the political implications of tax increases which would otherwise have been necessary.

A debt-equity swap policy has also been used in several countries characterized by high levels of foreign debt, for example, Argentine, Chile, Mexico, and Philippines. All of these-as mentioned-have attached great importance to privatization proceeds in order to reduce their foreign debts.

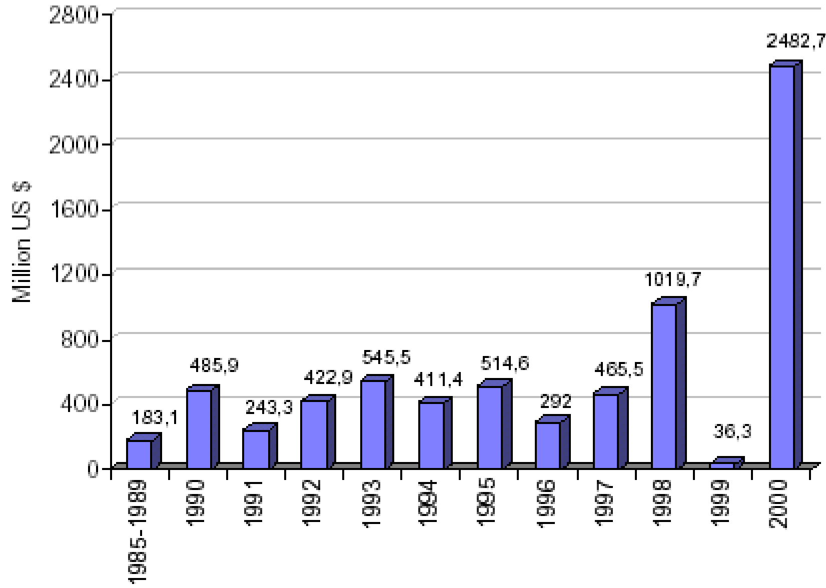
The same problem also affects Turkey, which is one of the most indebted countries in the world. When it is taken into account that Turkey's foreign debt rose to over 100 billion USD in 2000s, it is not difficult to understand how important the revenues of privatization are for the Turkish government.

The Dominant Characteristics of Turkish Privatization During the 1990s

An examination of the pattern of privatization in Turkey, as portrayed in Figure 1, suggests a comparatively stable pattern of low privatization revenues well into the late 1990s. It is striking that the maximum revenues generated in a single year has never exceeded the US $600 million mark in a single year right up to 1998. A casual inspection of the Figure 1 seems to point towards a major jump in privatization revenues in 1998, with sales proceeds exceeding the US $1 billion mark per annum for the first time. However, a major qualification is called for, in evaluating the sudden jump of 1998 because the sale of minority shares in İşbank, a privately owned major banking institution, has accounted for over sixty percent of the privatization revenues generated during that particular year. In retrospect, 1998 might have represented a major landmark in the history of Turkish privatization if the privatization of one major public enterprise, namely POAŞ (engaged in the distribution of oil) could have materialized, an issue which will be examined further in the subsequent section. The year 2000 represents a major landmark in the history of privatization program in Turkey. Almost US $ 2.5 billion worth of privatization was concluded as of August 2000. This has been the highest privatization realization ever reached in a single year by the privatization agency of Turkey. It compensates partially for the worst record experienced

in 1999 amounting to a dismal figure of US $ 36.3 million, an outcome which may be explained by the fact that 1999 constituted an election year and the absence of effective external pressure[2].

Figure 1: Privatization Implementation on an Annual Basis (1985-2000)[3]



There is an underlying consensus in the literature on the need to design an institutional framework for effective regulation as a critical precondition for welfare enhancing privatization. In fact, many investigators have drawn attention to the importance of creating a competitive environment as being more significant than the transfer of ownership per se. In spite of this apparent consensus in the theoretical literature on privatization, the regulation element, at least until very recently has constituted a neglected dimension of the Turkish experiment.

Although the privatization program effectively started in 1986, the legal framework for regulation in Turkey could only be established in October 1994, largely to meet the obligations imposed by Turkey's entry into the Customs Union with the European Union. The Competition Board, the key institution responsible for regulation is creation of this Law. However, this institution could initiate its operations only with significant time lag. The newly created institution has been quite vocal and active during the recent episodes of Turkish privatization.

The institution itself has generated a novel set of challenges. A striking example of these challenges became evident in the context of the proposed sale of POAŞ during late 1998 and early months of 1999. A conflict arose between the PA and the Competition Board on the grounds that the latter institution had not been consulted for approval during the initial phase of the privatization process. Subsequently, the Competition Board has effectively blocked the divestiture of POAŞ through its actions. The consortium of bidders initially interested in buying the enterprise have later declared they were no longer interested allegedly because of the new constraints imposed by the Competition Board that did not exist during the bidding process itself. The POAŞ affair clearly highlights the dilemmas experienced in Turkey in terms of privatizing large-scale enterprises, on the one hand, and the problems encountered in terms of effective regulation and imposing rules of fair competition on the other. Following this incident, however, we observe much closer cooperation between these two key institutions, with the Competition Board from that point onwards being actively and formally involved in the privatization process.

[2] Ercan, M.R., and Öniş, Z., 'Turkish Privatization: Institutions and Dilemmas', *Turkish Studies*, Vol.2, No.1, Spring 2001, pp.109-34.
[3] Source: DPT (State Planning Organization), 1998 and Periodic Bulletin of the ÖİB (The Privatization Administration of Turkey), August 2000.

Admittedly, to argue that regulation has been totally ignored, at least until very recently, would represent an overstatement in the sense that during the early years of the program, the "golden share" rule has been frequently practiced. The "golden share" implies that the government retains a very small share of the company's ownership in order to retain control over corporate governance and hence, indirectly performing a regulatory role in the post-privatization era.

However, in the absence of an institution specifically designed to implement the golden share formula, the desired outcome from a social welfare point of view could not materialize. In fact, there exist well-documented cases where the company has abused its monopoly power in the post-privatization context because of the failure of the government to effectively implement the golden share practice. A multitude of objectives have been identified in the context of the Turkish privatization program.

However, given the presence of large budget deficits and the underlying fiscal crisis of the state, the emphasis has been unambiguously placed on the goal of revenue maximization. The emphasis on fiscal gains has also been implicit in the most recent case involving the sale of public stake in İşbank in 1998 and partial sale of Tüpraş in 2000 while the overt objective had been announced as widening of share ownership in the spirit of popular capitalism. Indeed, it is fair to say, in retrospect, that the fundamental objective that one normally associates with a privatization program, namely an improvement in efficiency and the creation of a more competitive environment have largely been downplayed or de-emphasized in the Turkish context.

The Search For Strong Executive Authority

The architect of the Turkish privatization program, Turgut Özal realized the need to create a powerful bureaucratic institution which would be directly tied to the office of the Prime Minister while being largely independent from other key bureaucratic organizations responsible for economic policy making. The design of this powerful new institution proceeded in the following manner. First, the Law No. 2983 set out the legal foundation that allowed the establishment of the Housing Development and Public Participation Administration (HDPPA) in 1984. The overt objective was to create a new institution vested with the authority to finance mass housing and major infrastructure projects as well as to implement privatization. However, an implicit objective was to create a new managerial bureaucracy as a means of by-passing the possible constraints on the implementation of the program by the principal layers of the "classical bureaucracy", that arguably form the "pro-public enterprise coalition". Such groups who benefit from the existence of public enterprises in terms of power, prestige and employment are likely to lose their privileges in the aftermath of privatization. It is also striking that the HDPPA, as a newly empowered institution, governing the largest extra-budgetary fund, has not been subjected to normal budgetary discipline and parliamentary control. The very fact that it became directly responsible to the office of the Prime Minister is rather reminiscent of Latin American styles of decision making, with a corresponding absence of checks and balances that would normally be associated with a parliamentary form of governance. What was clearly intended is the creation of a highly centralized and autonomous institution. The most striking aspect of the legal framework established in the 1980s concerns the transfer of ownership and all the legal authority over the company on the privatization agenda to the HDPPA itself. The institutional model developed rested on a division of labor between the executive (i.e., the Prime Minister) and the Privatization Administration, as the technical-bureaucratic unit with a minimum direct role in the decision-making process. In such a setting, rapid privatization becomes possible only if the political authority is committed to this objective and possesses the political power to implement privatization. If these preconditions were satisfied, the PA would, indeed, emerge as a very powerful organization because the ownership of the company to be privatized is passed on fully to the orbit of this institution itself. In other words, the PA, by assuming the sole control or authority over the enterprise to be privatized, effectively cuts the link between the enterprise and the Minister previously empowered with its ownership and control. This division of labor may work very effectively when a dominant party (or a president in the Latin American context) is in power and strongly committed to the success of the privatization program. This two-tier structure may facilitate a speedy decision-making process, limiting interference from other layers within the state. However, when a coalition government emerges with weak commitment to privatization and reform, the apparent "autonomy" of the institution with respect to other layers of the state largely disappears. In the context of a fragmented state, the ability of this newly created institution to engineer a process of rapid privatization fails to materialize because, by definition, the decision-making powers are vested solely with the executive itself. This pattern is clearly observed in Turkey as the Turkish political scene during the 1990s has been characterized by a highly fragmented party system and successive coalition governments with serious ramifications concerning the fortunes of the privatization program. The formation of a new government involving the right-of-center True Path Party (DYP) and the left-of center Social Democratic Populist Party (SHP) in 1991 marked the starting

point of coalition politics in Turkey in the 1990s. These two political parties, in spite of their ideological differences, have shared an identical mistrust of the privatization process. In fact, both parties while in opposition had played an important role in reversing early block sale of public assets to the private sector. Once the commitment of the executive or the political authority vanishes, then inevitably the privatization process becomes lengthy and politicized, with new sale of public assets abandoned or earlier sales reversed as a natural outcome of this politicized environment. The lack of governance and commitment has been an obvious reason not only in the slow implementation of the privatization program, but also in the areas of tax reform, social security reform, and implementation of an overall disinflation program. One could argue that the legacy of étatism generated a widespread suspicion of privatization. This étatist mind-set rendered even the proponents of privatization insecure about their own positions and often put them on the defensive. Discussions frequently centered around the protection of the public owned goods against potential political abuses. Efficiency arguments were rarely emphasized. The nature of Turkish politics and more specifically the party system are also critical in understanding the fortunes of the privatization program. One needs to recognize that Turkish politics is characterized by patronage politics. Parties are typically clientelistic networks whose major function is to channel public resources to create their own bases of political support. What is important in the Turkish context is that even strongly pro-private enterprise political parties did not push for privatization in practice because it would take away significant patronage opportunities from them. Lip service was paid to the need for privatization but achievements were limited. In fact, limited privatization that occurred appeared to be tied in with patronage. One could go even further and argue that rent-seeking behavior and outright corruption have been central to an explanation of limited privatization in Turkey. Such corruption through insider trading, false information, lack of transparency and illegitimate business ethics has become one of the critical aspects of the Turkish economy as witnessed throughout the 1990s. This, in turn, has exercised a rather adverse impact on the overall progress of privatization in Turkey. The link between the political environment and the legal framework became critical to the fortunes of the privatization program in two critical respects. First, opponents of privatization, who also form part of the pro-public enterprise coalition, including some members of the political elite, certain layers of the bureaucracy, labor unions and intellectuals committed to a statist ideology, have effectively exploited the absence of a Privatization Law until the enactment of a comprehensive privatization law in 1994. The privatization process has been marred by major and costly legal setbacks. The dominant logic underlying the decision-making style instituted by Õzal favored decrees with the force of law in order to accelerate the pace of the privatization and the overall reform process by overriding political or bureaucratic opposition. However, opponents of privatization have utilized the weaknesses of the legal infrastructure as a way to bloc the progress of the privatization program in Turkey. "Politics within the state" is critical to this argument since the Constitutional Court, a key institution of the legal arm of the established state apparatus, has emerged as a critical institutional vehicle in translating the explicit and formal demands of the opposition into a concrete blockage of the privatization program. A crucial dichotomy underlying the political economy of Turkey during the late 1980s and the early 1990s has been that politicians who oppose privatization while in opposition changed their positions drastically or at least became partial supporters of privatization in when they came into government. This apparent contradiction may be explained primarily by a domestic factor, namely the fact that parties in office perceive privatization as a source of revenue for overcoming the underlying fiscal crisis of the state. Perhaps, to a lesser extent, the changing global context more favorable to privatization, in the course of the 1990s has also been instrumental in accounting for the U-turn in the approach of the parties in opposition when they actually came into office. However, even if a Turkish government, in principle, feels forced to proceed in the direction of privatization, the absence of an adequate legal framework and the presence of well-organized opposition lobbies who capitalize on this very absence, create a serious set of barriers to the progress of privatization. This problem could be solved, in principle in the Turkish context, via an amendment in the Constitution itself. Yet, this is a rather complex process in the Turkish setting because it requires a two-thirds majority in the Parliament, the achievement of which in the 1990s has been an almost insurmountable task. The second best solution would be to introduce a Privatization Law, which conforms to the basic spirit of the Constitution. However, the enactment of such a law has not been possible until 1994. Consequently, governments in power had to resort to a piecemeal and ad hoc approach, trying to make individual designs for particular cases of privatization resulting in costly delays. The year 1994 represented a critical point in the evolution of the Turkish experiment. After a significant delay, the Privatization Law has finally been introduced. To some extent, this has managed to overcome the deficiencies of the legal framework encountered during the initial years of program implementation. The new law provided greater flexibility in the choice of privatization techniques and emphasized transparency in all transactions. Another key innovation involved the explicit recognition of labor adjustment issues and redundancy payments for displaced workers. As part of the new legal framework, the proceeds of privatization could now be utilized for meeting the costs of divestiture, compensation of displaced labor and financial restructuring of enterprises in the PA portfolio. A critical implication of the new Law involved the inevitable weakening in the power of opposition lobbies to reverse privatization decisions through the Constitutional Court. However, opposition lobbies continued to be an active

and vocal source of blockage for the privatization program as testified in the case of the telecommunications privatization process in the case of what the general privatization law proved to be inadequate. Strong opposition to telecom privatization manifested itself, on this occasion, as an opposition to the Telecommunication Laws of 1994 and 1995 themselves. In particular, it has been alleged that these laws have not conformed to the basic principles of the Constitution. This criticism, in turn, has been effective in the annulment of these laws. Lack of institutionalized bidding procedures, especially in valuation techniques and the formation of valuation committees have been singled out as the critical missing elements underlying the decision to abandon the telecommunications laws. A new Telecommunication Law was passed in 1996 with no reversals to date. The Constitutional Court's rulings on valuation techniques led to the annulment of the related clauses of the Privatization Law of 1994. An amendment to deal with this problem was accomplished in 1997. More recently in 1999, the concept of privatization has, at last, been incorporated into the Turkish Constitution as a by-product of accepting the rules of international arbitration. The acceptance of the rules of international arbitration heavily demanded by foreign investors for a long time illustrates the importance of the influence exercised by international actors, notably the transnational corporations, in gradually weakening of the étatist coalition. From a broader perspective, an interesting question arises from the Turkish experience concerning the position of the Constitutional Court, as a key component of the state, in influencing the implementation of the privatization program. Hitherto, the emphasis has been on the negative role whereby opponents of privatization have utilized this institution to bloc the very momentum of the privatization process itself. It would be extremely misleading, however, to view the Constitutional Court on a totally negative light. One also needs to acknowledge the positive aspect of having a strong and independent institution like the Constitutional Court in terms of avoiding possible abuses of the privatization process involving severe under-valuation of public assets for example. This concurs with our earlier observation that hyper-privatization, achieved over a very short period of time, may not be welfare enhancing. If anybody is to be criticized for the slow phase of privatization in Turkey, it is not the Constitutional Court, but the politicians for their failure to institute a sound and constitutionally compatible legal framework in a timely fashion[4].

The Vicious Circle Of Macroeconomic Instability

It has been argued that the most significant achievement of Turkish privatization to date has been its contribution to the development of capital markets in Turkey (Ertuna, 1997). Empirical evidence for this assertion is provided by a study which covers the period from 1989 to 1993. During the period concerned, 14 public offerings of companies on the privatization agenda appear to have represented 15.7 percent of the total number and 42 percent in value terms of the initial public offerings in Turkish capital markets. Moreover, it was found that these offerings, in the long run provided better rates of return compared to private sector issues (Özer, 1995).

While it is true that privatization in Turkey provided a major initial boost to capital market development, this did not prove to be a sustainable process during the 1990s. Furthermore, when we consider the pace or depth of capital market development in comparison with other "emerging markets" we fail to observe a dramatic increase in the relative position of the Turkish capital markets among emerging capital markets (ECM). In the overall total judged by various indicators including market capitalization, trading volume and the number of trading companies involved, the share of the Turkish market still remains low. In fact, the comparative evidence suggests that the Turkish capital markets, in spite of sporadic developments, have failed to accomplish a major jump in the hierarchy of emerging markets. Arguably, if a major breakthrough had been established with respect to the implementation of the privatization program, the intensity and depth of capital market development in Turkey could have been significantly more pronounced. Large fiscal deficits and macroeconomic instability have remained a persistent problem in Turkey throughout the 1990s. One may hypothesize that limited privatization and macroeconomic instability constitute a two-way relationship. Macroeconomic instability, in an environment of political uncertainty, has, in turn, restricted the country's ability to attract foreign direct investment on a sufficient scale. The inability to attract foreign direct investment exercised a negative effect on the pace of privatization in Turkey. However, a major qualification is called for, however, in the sense that Turkey, at no stage, could present a fully prepared privatization project sufficiently attractive to foreign investors. Furthermore, restrictions have been placed on the participation of foreign investors in areas considered to be of strategic national interest. The vicious circle involving macroeconomic instability, limited capital market development and limited foreign direct investment has encouraged a pattern of unstable economic growth in Turkey, a process which has been dependent on the ability to attract large inflows of short-term capital in response to high domestic interest rates. It is clear that a major breakthrough in the privatization effort possesses

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[4] Ercan, M.R., and Öniş, Z., 'Turkish Privatization: Institutions and Dilemmas', *Turkish Studies*, Vol.2, No.1, Spring 2001, pp.109-34.

the potential to convert the "vicious circle" into a "virtuous circle". A major boom in privatization activity would be instrumental in reducing the size of the fiscal deficit, accelerating the pace of capital market development and the magnitude of long-term capital inflows which, in turn, may feed onto each other, providing the basis of a cumulative improvement in economic performance[5].

Concluding Remarks

Turkish governments have done a poor job at convincing the public that the main goal of privatization is increased efficiency and productivity rather than the creation of a new source of revenue to finance the public deficit. Therefore, most Turks have come to see privatization as a means of generating revenue ‘to patch the hole of the budge’. This belief gained legitimacy when Erbakan decided to include projected privatization proceeds into the 1997 ‘balanced’ budget.

Delays in setting up a minimum social safety net for aid-off workers is another reason for the slow pace of privatization in Turkey. The country does not have an unemployment insurance system and dismissed workers are generally paid only an amount equal to only one-year worth of income.

So far, the number of lay-offs has remained limited to a few thousand but even the smallest increase could result in massive social problems. Perhaps it is the fear of social unrest which underlies the government’s decision to avoid privatizing the most labor-intensive SOEs- i.e., the railways, charcoal mines and the post office which altogether employ almost half of all SOE workers. Agricultural SOEs, excluding the State Tobacco Monopoly (Tekel), have also been spared from privatization. These agricultural SOEs, (again, except for Tekel) are big loss-makers whose financial deficits are closely related to the purchase o commodities at subsidized prices from farmers to sell at market prices.

Given the fact that there are twenty-odd million farmers and peasants in Turkey, politicians have perceived that cutting subsidies to agriculture has been too costly and, as a result, no reform in agriculture has been initiated so far.

The Turkish government’s current method of the current privatization involves anything but selling SOE shares in the financial market. This is because of the disappointment associated with Teletaş’ privatization in 1988. Following the privatization of Teletaş, the value of company’s shares dropped drastically due to the shallowness of the financial market. Policymakers drew several lessons from the operation and, thus, governments in the past three years have been trying to sell SOEs through tenders rather than privatizing them via the stock market.

In 1995, a new strategy was also tried in the case of Kardemir steelworks when the company was transferred for one symbolic Turkish Lira to its workers, local people and a group of industrialists. The outcome of Kardemir’s ‘privatization’ has been impressive. The firm modernized its technology using foreign credit, doubled its output in 1996 and, for the first time in years, it is operating at a profit now. Kardemir’s successful privatization was due to one necessary condition, though: the workers accepted a large real wage cut.

The current coalition government led by the ANAP is considering applying ‘the Kardemir way’ of privatization to other small steel and charcoal SOEs. But for larger SOEs, the government has to find domestic and foreign buyers-a task which is not always easy given the government’ price tag for SOEs. For instance, the sale of Erdemir, a highly profitable iron and steel producer, was postponed twice. In 1996, the government was unsatisfied with the bids it attracted whereas in 1997, only two bidders participated in the auction.

A similar event may occur in the privatization of Turk-Telekom, which is at the center of the current privatization program. Turk-Telekom’s estimated market value has fallen from 40 billion USD in 1993 to 20 billion USD in 1997. The reason being that too many telecommunication companies are up for sale in the international market. Turk-Telekom’s market price may fall even further and the Turkish government may face difficulty in selling the company for 20 billion USD in 1999.

Today, the Turkish public is more receptive towards privatization than it was in the past. In addition, the state courts recently began to adopt a more flexible stance towards privatization. For instance, after two cancellations

[5] Ercan, M.R., and Öniş, Z., ‘Turkish Privatization: Institutions and Dilemmas’, *Turkish Studies*, Vol.2, No.1, Spring 2001, pp.109-34.

of the Turk-Telekom legislation on constitutional grounds, the Constitutional Court finally took a step toward clearing the sale of Telekom in 1997. Therefore, the current Turkish government has the advantage to push privatization through. Yet, linking privatization to a fall in the rate of inflation, as some argue, is false.

Even if the sale of SOEs is completed within two years (an unlikely event), inflation-the most important macroeconomic problem in Turkey-may not fall. Neither revenues from privatization nor a reduction of budgetary transfers to SOEs may succeed in reducing inflation, which has averaged 70% in the last decade and reached over 90 % in 1997.

A serious drop in inflation is possible only when the Turkish government is able to collect sufficient taxes, overhaul the social security system, privatize state banks, trim subsidies and cheap credits to agriculture and cut defense spending. For instance, in 1996, transfers to social security institutions equaled 2.5 % of the GDP while transfers to SOEs fell to a manageable 0.3 percent of the GDP. In sum, the SOE sector is only one cause, of Turkey's economic problems at the structural level. Privatization, while necessary, should not be viewed as a panacea to the country's macroeconomic instability.

To sum up, experiences with structural adjustment policies, however, necessarily differ because each country has its own domestic pressures and manner of interacting with the international system (Shaker, 1995:1).

THE PRIVATISATION PROGRESS OF MEXICO

An Economic Outlook and NAFTA

The state-led development strategy relies on public-sector investment, still heavily skewed toward agriculture, to integrate the national economy. The government expropriates all foreign oil operations and nationalizes the oil and petrochemicals industry in 1938, winning President Cárdenas widespread praise within Mexico. The country enjoys strong economic growth and low external debt. Mexico supplies the World War II Allies with war equipment and its own population with consumer goods. This marks Mexico's transition from a primarily agricultural economy to an industrial one. The government owns and operates most strategic industries, including energy, transportation, communications, and some manufacturing. The National Finance Bank is reorganized to foster industrial expansion.

The government continues its inward-looking development strategy of import substitution. The peso is undervalued, and state credit is available through several state-owned development banks to foster industrial development. Government increases its involvement in the economy and invests in major infrastructure improvements, paying little attention to the demands of labor and rural populations.

The economy continues to grow with government support. Its strength brings increased foreign investment and control by foreign, mainly U.S. interests. In a nationalistic strategy, the government buys many foreign utility concessions in 1960. Government policy shifts from an urban focus to a rural one, with massive land redistribution and new land made available for small-scale production. Government spending increases rapidly in an ominous sign of things to come. Business interests once again receive priority. Manufacturing is the government's dominant growth sector. Electric power and mining companies are nationalized. The government encourages the establishment of maquiladora (assembly) plants along the border to offer foreign investors proximity to the U.S. and low labor costs.

Fiscal mismanagement undermines economic growth. With the discovery of oil reserves, Mexico ends its policies of stabilization and embarks on a massive public spending program. Low real interest rates discourage domestic savings. Government's anti-business stance deters foreign investment. Warning signs of an impending financial and economic crisis are swept under the rug.

Mexico becomes one of the world's largest producers of oil, and one of its leading debtors as the government goes on a borrowing spree. Creditors are easily found given Mexico's immense oil revenues. The government assumes ownership of hundreds of unprofitable firms, but the government's spending habits and the collapse of commodity markets put the economy into recession. The economy contracts. High interest rates, falling oil prices, and rising inflation put Mexico near bankruptcy. Mexico's inability to service its debt sparks a global crisis, and emerging markets are cut off from international capital. To stem massive capital flight, President

Portillo plans to nationalize private banks. The U.S. Treasury and Federal Reserve Board intervene with a rescue package.

Austerity measures, imposed in part by the IMF, reverse economic growth trends but fail to restore sustainable growth rates. The stringent economic stabilization program helps reduce fiscal deficit and restores export growth, but at the cost of unemployment and lower real wages. Two-thirds of foreign investment are concentrated in the maquiladora areas along the U.S. border. Mexico reaches an agreement with external creditors on debt reduction and restructuring. Government ends restrictions on foreign ownership of business and promotes privatization. Commercial banks begin to be re-privatized. Import substitution gives way to participation in global free trade. As a result of these measures, Mexico sees a brief economic upturn that slows again in the early '90s.

The barely stable economy suffers another blow with the devaluation of the peso in 1994. Investor panic causes Mexico's stock exchange to plummet, setting off a domino effect in the rest of Latin America. A U.S.$ 20 billion bailout and increased exports through the North American Free Trade Agreement (NAFTA) help stabilize the economy and bring about signs of recovery in 1996.

Mexico's GDP grows at a steady rate for three consecutive years. Significant oil revenues in 2000 enable the government to repay its debt to the IMF, but at the same time the United States's economic slowdown deals a blow to the Mexican economy, and growth stagnates. The positive effects of trade liberalization, privatization, and increased competition have weakened.

President Fox announces he is committed to re-launching growth and prepares Mexico for a new series of measures aimed at deregulating the economy. Growth depends in large part on how the economy of the United States fares.

Privatization and Economic Stabilization in Mexico

In the 10 years since the outbreak of the international debt crisis, Mexico has made an unprecedented transition to an externally oriented economy with a rapidly expanding role for the private sector. Viewed as the key element role for the private sector. Viewed as the key element of success, privatization occurred simultaneously with a major economic adjustment program with strong political support.

The Experience with Privatization of Public Enterprises in Developing Countries

Privatization, when correctly conceived and implemented, fosters efficiency, encourages investment and thus new growth and employment, ad frees government financial resources for investment in infrastructure ad social programs.

Privatization experience in a number of developing countries has shown that private ownership of productive assets makes a difference and that state ownership of firms seldom allows sustained good performance.

During the past decade, more than 80 countries, most of them developing ones, have launched ambitious efforts to privatize their state-owned firms. Since 1980, more that 2,000 public enterprises (PEs) have been privatized in developing countries. Similar to the Mexican experience, the process in most of them started with the divestiture of smaller firms, only to be followed in the past couple of years by the sale of larger enterprises.

Historically, developing countries have created public enterprises or acquired firms from the private sector for many reasons- to complement or replace weak private sectors, to produce higher investment ratios and extract a capital surplus for investment in the economy, to generate employment, to make goods available at lower cost, and to transfer technology to strategic sectors. Experience in most cases has been that while some public enterprises have been productive and profitable, a large number of them have been economically inefficient, incurred heavy financial losses, and absorbed disproportionate shares of domestic credit and fiscal transfers. For example, public enterprise losses as a percentage of GDP reached 9% in Argentina in 1989; government transfers ad subsidies to PEs in Poland amounted to more than 9% of GDP that same year; about half of some 350 PEs in Tanzania persistently made losses during the 1980s; and in China, in 1991, some 30% of all the PEs were operating at a loss.

Beginning in the 1970s and continuing through the early 1980s, practically all developing countries adopted programs to remedy the causes of poor PE performance, in most cases without attempting to change the ownership. While many of these programs had positive results, either initially or temporarily, they were difficult to implement and even harder to sustain. Growing recognition by governments that piecemeal, partial reforms of PEs have limited ad unsustainable result helped fuel the drive to privatization in the 1980s.

In this respect, too, Mexico was one of the pioneers among the developing countries in realizing relatively quickly and early in the reform process that sustainable fiscal performance and adequate public sector investment programs will depend critically on the speed, depth and success of the divestiture of program.

Empirical evidence shows that domestic welfare, defined as changes in costs and benefits to all economic actors affected by the privatization, increased in 11 out of 12 privatization cases analyzed by the World Bank in three developing and one developed country. Productivity went up in eight of the 12 and did not decline in the other four.

Expanded investment and diversification of production resulted in fast growth in many of the firms; labor as a whole was not worsened; in nine of the 12 cases analyzed workers benefited, although in most cases privatization entailed some layoffs. In sum, buyers of the privatized PEs made money, but other stake-holders-labor, consumers and government- also gained.

Other empirical studies and data show that privatized companies experience faster growth and grater cost containment. Fully or partially privatized PEs in developing countries show increased return on sale, assets and equity, improved capital structure and reduced leverage, increased capita expenditures, and somewhat increased workforces as a result of higher investments.

It is interesting to note that most success stories come from high-or middle-income countries; in this respect, Mexico's example of a successful privatization program is no exception. It is harder t privatize in the least-developed settings, but even in low income countries the results of some privatizations have been encouraging.

Two major factors-in terms of economic productivity and consumer welfare- are critical for the outcome of privatization: the nature of the market into which the PE will be divested and country conditions. Privatization of enterprises in competitive, and particularly tradeable, sectors such as industry and agriculture is likely to yield quick economic benefits, as long as there are no economy-wide distortions that hinder competition.

Privatization will also yield more immediate and grater benefits the more market-friendly the overall policy environment. Also, privatization of enterprises in noncompetitive markets-usually large PEs operating as natural monopolies, such as power and other infrastructure utilities and telecommunications enterprises-requires that a regulatory system be in place to protect consumer. Thus, middle-income countries tend to be in a better position to privatize their PEs rapidly and effectively in noncompetitive sectors.

Mexico, with its relatively well functioning legal framework, considerable regulatory capacity and adequate macroeconomic policy environment, has been one of the most successful examples f a wide scale PE divestiture.

As in any reform process, defining clear and simple objectives of privatization is sine qua non for a successful privatization. While the authorities need not attempt to plan the privatization to the last detail, they do have to spell out the principles, choose between potentially conflicting objectives, and supervise the fairness and outcome of the process.

Mexico's experience is a clear example of how important it is to set clear objectives very early in the process; the authorities made efficiency enhancement their principal goal of divestiture, using privatization to enhance competition and by ensuring a competitive market reinforcing the benefits of privatization. While fiscal results of divestiture are at times considerable, revenue maximization should not be the primary consideration. Often it is more important to eliminate monopoly or oligopoly power and to unleash potentially competitive activities than to maximize revenues from sales into protected markets.

Also, it is more beneficial to construct appropriate regulatory frameworks to protect consumer welfare than to increase government revenue by selling into an unregulated market. In addition, short-run distributional

considerations of privatization, though they cannot be ignored, should not come at the expense of managerial competence.

Privatization should aim at improving corporate governance, and that may mean foregoing widely dispersed ownership in favor of an owner with enough at stake to have strong motivation and control to turn around an enterprise in difficulty. Again, Mexico offers a number good example of the above.

As mentioned before, Mexico began selling off smaller and medium PEs in competitive markets, learned in the process, and then moved on to larger, more complicated transactions. This is a lesson other developing countries would be well advised to emulate. There are, however, no general recipes and the choice of where to begin depends on investor interest, government capacity, and on which sectors and firms are in most need of new investment and efficiency improvements.

Governments choosing to start with large firms (e.g., Argentina) do so because they suspect the window of political opportunity may not be pen for too long, that the sale of a major enterprise will signal commitment to investors and investors and markets, and that the economic returns of enhanced efficiency in large firms will outweigh the potential risks.

In countries with weak capital markets and banking systems, limited investor interest, and weak regulatory capacity, private management arrangements can be a temporary/transitory solution on the path to an all-out privatization.

Management contracts, if correctly drawn up and executed, can represent a considerable gain to the firms' owners, but they require adequate drafting and supervisory capability in the government. Given its macroeconomic conditions and regulatory capacity, Mexico, as will be shown later, did not opt for private management arrangements in its privatization drive.

Any divestiture of public assets, particularly in the case of larger PEs, is wrought with political sensitivities that require adequate public awareness campaigns. The costs and benefits of a sale of PEs need to be explained clearly; sometimes restructuring –legal, organizational, and managerial changes, financial workouts, and shedding of labor force-may be a necessary prelude to the divestiture of a large PE.

Many countries have changed management and settled the liabilities f the PEs to be privatized to enhance the chance for a successful sale. Both in the sale of its smaller PEs in the early stages of the privatization program and particularly later when large PEs were put up for sale, the Mexican authorities have conducted an effective campaign making the public and other stakeholders aware of the process under way.

Frequently, with the help of the government's financial agents, some restructuring and management changes were undertaken before the sale transaction itself. However, large new investments for plant modernization or rehabilitation prior to sale should be avoided: getting the private sector to finance investments and take the risk is a principal reason for divestiture in the first place. There is no evidence that governments recover costs of physical restructuring via higher sales price; in Mexico, with public finances under pressure throughout the period of PE privatization, the government did not undertake any major modernization or rehabilitation before putting the PEs up for sale. Fear of public outcry if and when labor would be laid off as a result of privatization has been a major factor making many governments postpone or shy away from a divestiture of a PE.

Nevertheless, actual experience shows that labor does not, and need not, lose in privatization, particularly if the authorities pay attention to easing the social cost of unemployment through adequate severance pay, unemployment benefits, retraining and job search assistance. Mexico is a good example of how labor can actually benefit from the change of ownership of PEs.

Another important aspect of privatization is it's financing. From the government's point of view, sales for cash are clearly preferable to accepting debt; outright sale makes the break between the firm and its prior owner cleaner; cash also becomes handy, as liquidity is needed to settle enterprise liabilities, including severance pay. As regards the price of the transaction, ideally the market should set the price, but in the real world, negotiated settlements and financing arrangements or debt/equity swaps are often unavoidable. Mexico acquired considerable experience in negotiating the value of the smaller PEs in the earlier years of the program and subsequently perfected the authorities' know-how in negotiating with potential buyer in larger transactions.

The experience of privatization of productive assets and firms in the past decade has shown that increasingly, governments all over the world are moving to tap private sector management skills and financial capacity to pursue their goals of economic development. Privatization ahs become a necessary step on the path to higher efficiency. As such, it should be viewed as a complement to, and not a replacement for, other aspects of economic development. However, governments intent on privatizing face a challenge: privatization's benefits of efficiency and innovation only materialize if done right and in a transparent way.

Economic Development and Stabilization Policies in Mexico

Structural adjustment policies were strengthened with the initiation of economic deregulation policies, a vigorous privatization program of large public enterprises, and important legal reforms in the land tenure system and negotiations on a free trade agreement with the U.S. and Canada (NAFTA).

The economy has shown encouraging signs of economic recovery, let by a strong resurgence of private investment and, to a lesser extent, private consumption. Economic growth averaged 3.7% p.a. between 1989 and 1991 and has been driven by the private sector. Growth was fueled by massive private capital inflows of approximately 14 billion USD from 1989 to 1990 and 20 billion USD during 1991.

These inflows financed an increasing current account deficit and also contributed to an important accumulation of reserves of about 11 billon USD between 1990 and 1991. Inflation was reduced to 19.7% in 1989, increased to 29.9% in 1990 mainly due to flexibilization of price controls and adjustment of public sector prices, and reached some 18.8% in 1991. Reducing inflation is a primary goal in the strategy of the government, to which end a stringent fiscal policy is maintained. Domestic interest rates that were unsustainably high during the initial stages of the Pacto stabilization program due to the credibility problems described before –'ex-post' real interest rates on domestic public debt averaged about 30% during 1988 and 1989-fell substantially as a result of the improved economic climate and a strong reduction of the Public Sector Borrowing Requirement (PSBR).

Ex-post real interest rates on domestic public debt for 1990 and 1991 were approximately 8% and 2%, respectively. The PSBR was reduced due to a continued restrictive fiscal policy which is projected to lead to a financial surplus of the public sector during 1992. Additionally, the revenues from the privatization of some bigger enterprises did not enter directly into the Treasury but was put into a Contingency Fund at the Central Bank Subsequently this Fund has been used to retire outstanding public debt, mainly domestic debt, which contributed further to a reduction in domestic interest rates and which has had a favorable impact on public finances. Throughout the period of economic stabilization and adjustment programs in Mexico, there has been an emphasis on the strengthening of public finance, both through expenditure reduction and improve tax administration.

The Disengagement Program of Public Enterprises in Mexico

The divestiture of public enterprises in Mexico started in 1983 and ahs continued for almost a decade. In the initial stages of the program, the main focus of policymakers was on macroeconomic stabilization. The urgent need to trim public sector expenditures and to reduce the public sector deficit as part of the stabilization effort described in the preceding section led to a rapid reduction in investment programs of state-owned enterprises as well as an important disengagement of public enterprises.

Disengagement took place through liquidation of assets, sale of companies to the private sector, mergers or transfer to local authorities. Thus the number of state-owned enterprises was reduced from 1,155 at the end of 1982 to approximately 220 in mid1992. The major reduction in the number of state-owned enterprises took place from 1982-1988, a reduction by 743 entities.

However, a minor part of this reduction took place through the sale of companies to the private sector. From 1982-1988, 154 direct sales of companies to the private sector took place, compared to some 208 operations in the period from 1989 t mid-1992. In this latter period, the reduction of the number of state-owned enterprises was very similar to the number of privatizations, The number of sales operations even exceeded that o reduction of state-owned enterprises due to the splitting up and sale of parts of former conglomerates, e.g. in the fertilizer, food processing, and food distribution industries.

It becomes clear that in the initial stages of the disengagement program n Mexico, methods such as liquidation and mergers were mainly used to reduce the number of state-owned enterprises and the size of the public sector in general, whereas in the later stages the privatization method prevailed.

The main reason fro this was the fact that the most obvious candidates for disengagement were relatively small and financially unviable public enterprises, whereas in the latter stages the enterprises being proposed for disengagement were the more profitable and/or bigger ones.

As a consequence, it can be stated that the impressive reduction in the number of public enterprises did not always reflect a similar decrease of the direct state participation in domestic production. As pointed out before, especially in the early stages of the disengagement program, it was mainly small and medium-sized enterprises that were divested.

Only starting in 1988 were some bigger companies such as airlines, steel and fertilizer complexes, the telephone company, and the commercial banks privatized. The Mexican authorities have continuously stressed the need to start with smaller entities in privatization programs in order to obtain experience in the process of selling, negotiating and keeping the program transparent.

An additional advantage of this strategy has been that as the initial privatizations of companies that were mainly operating in competitive markets took place, such as tradeable goods production, no major effort was required to put an appropriate regulatory framework in place. It can be said that the strengthening of public finance in addition to the increase in economic efficiency as the main objective of the Mexican privatization program. The sales of the bigger entities during the later stages of the stabilization program have led to higher prices being paid, which would not have been possible some years earlier due to a lack of confidence in the macroeconomic outlook.

The external debt relief obtained through negotiations with external creditors in July q989, and finally formalized in early 1990, reduced considerably the uncertainty arising from the high level of external debt service. The timing of the privatization of some bigger entities such as the steel industry, the commercial banks and the telephone company, almost all within a period of two years after the formalization of the debt restructuring, cashed in on the rapidly improving investment climate obtained through the debt relief.

Both domestic and international investors were offered large investment opportunities in the privatized enterprises, which led to an important capital inflow. Had the possibility to buy into and take over the state companies not existed, capital inflows into the country would probably have been substantially lower as new direct foreign investments normally take a longer period to mature.

The revenues from the sale of public enterprises amounted to more than 20 billion USD in a two and half year period, 1990 to mid-1992, averaging the annual equivalent of 3% of Mexico' GDP during the 1990-92 period. More than 90% of this amount corresponds to the sale of the telephone company and of the commercial banks. These revenues were used to reduce the size of the domestic public debt which in turn has led to an important reduction of domestic interest rates and a further improvement in Mexico's public finances.

The Mexican public enterprise disengagement program ahs successfully contributed to the strengthening of public finance, as the major part of the revenues obtained from the sales of public enterprises have been used to reduce public debt and not to increase current expenditures. The authorities have insisted since the beginning of the large PE privatization sin 198 that the rationale to sterilize the revenues of the sales is provided by the special nature of the transactions, namely that the revenues from privatization are a one-time ad not a permanent income for the public sector.

Since the strengthening of public finance has been one of the main objectives of the Mexican privatization program, the timing of some privatizations, especially of bigger enterprises, has been adjusted to the overall economic and investment climate in order to obtain better sales prospects and higher revenue maximization attitude of the Mexican authorities to the detriment of economic efficiency. The majority of the disengagement program took place in enterprises operating in competitive markets, either with national or international competition. In the absence of competition, a generally acceptable regulatory framework has been set up prior to the sale of public enterprises, as in the case of the telecommunication and banking sectors. Nevertheless, it can

be expected that there will also be room for increased private sector participation in these sectors that are currently limited to the public domain by the Mexican constitution.

The private sector is taking an increasingly active role in a number of areas that traditionally have been dominated by the public sector, including the construction and operation of toll roads, ports and airports, a role that is expected to be extended to other, mainly infrastructure-related activities.

An improved regulatory framework is gradually being put in place in all of the activities where concessions are given to the private sector to build facilities and to provide services for a predetermined time period. As was the case in the earlier stages of the Mexican privatization program, an important consideration in extending the possibilities of private sector entry into these areas is the limited availability of public resources for the huge investment requirements if Mexico is to modernize its physical ad other infrastructure.

Concluding Remarks

This part of the paper attempted to describe Mexico's privatization experience in the past 10 years. Divestiture of public enterprises took place simultaneously with a major stabilization and structural adjustment effort, a process that has been widely recognized as a very successful one by any standard.

In the 10 years since the outbreak of the international debt crisis which started with Mexico's inability to service its external obligations, the country has made an unprecedented turnaround in its economic model, transforming itself into an outward-oriented economy with a growing role played by the private sector in an increasingly market-friendly environment.

The role of the state has been redefined in a far-reaching way by a dramatic improvement n public finances and the by the government's capacity to deal with external shocks. Even more important than the reduction in the size of the state in Mexico's economy has been its qualitatively new role as an effective regulator of an economy led by the private sector.

Mexico's privatization and disengagement record has been as impressive as its achievements on the stabilization and structural change fronts. In fact, its divestiture of a number of key sectors and activities has been in itself an important part of the structural change-taking place in the country in the past 10 years.

The policy makers were convinced from the outset that it would be impossible to implement the intended fiscal improvements and market reforms without dealing in a systematic and comprehensive way with Mexico' bloated public enterprise sector, which had grown to almost one-fifth of the country' GDP in the two decades preceding the 1982 crisis.

Mexico's successful privatization experience has much advice to offer to other developing countries who are carrying out divestiture programs.

First, clear, simple and publicly shared objectives of a privatization program are needed. Piecemeal, partial reforms of publicly owned firms usually have limited and at best temporary results.

Second, the more market-friendly a country's policy framework and its capacity to regulate, the less difficulty it will have in selling a PE.

Third, PEs operating in competitive markets should be prime candidates for privatization. In this context, countries may be well-advised to start with small firms and gain experience and self-confidence to deal with larger, more complex transactions.

Fourth, large government investment/restructurings in PEs to be privatized should be avoided; the costs and risks usually outweigh the rewards to the state.

Finally, keeping the principal stakeholders and public at large well informed about the privatization process and making the divesture program transparent is key to a successful conclusion of any privatization[6].

[6] Voljc, M., and Draaisma, J., 'Privatization and Economic Stabilization in Mexico', *Columbia Journal of World Business*, April 1993, pp.122-143.

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APPENDIX

Appendix I

Country Breakdown of Amounts Raised by Privatization, USD Million[7]

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Mexico	3,124	10,757	6,864	2,531	766	170	73	2,671	988	279	406
Turkey	486	244	423	566	412	572	292	466	1,021	38	2,712
Total World	16,112	20,925	25,586	40,461	55,885	54,599	53,022	96,282	100,633	96,735	67,119

[7] Source: OECD Country reports (several years).