

Turkish Privatization: Institutions and Dilemmas

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Based on a critical examination of Turkey's privatization experience during the 1990s from a comparative perspective, the study tries to confront the larger question of why some countries have been quite successful in undertaking large-scale privatization, while others have not. Three central, interrelated influences are highlighted: the executive authority's strength and coherence, the depth of economic and political crises experienced prior to implementing the privatization program, and the external environment. Special attention is directed toward a key new institution, the Turkish Privatization Administration, the underlying logic of which is very close to similar highly centralized institutions in Latin American countries dominated by presidential styles of decision-making. The Turkish experience testifies, however, that such institutions cannot perform successfully in political environments characterized by fragmented party systems and weak executive authority, at least in the absence of a major state fiscal crisis and resulting pressures from the international community for large-scale privatization and reform.

Privatization emerged as a key element of the Turkish neo-liberal experiment in the 1980s designed to accomplish successful integration into the world economy. The privatization component of neo-liberal strategy focused on increasing efficiency, reducing the burden of the state economic enterprises (SEEs) on the government budget, and broadening property ownership.

In retrospect, however, we observe a paradox. Although the privatization process in Turkey started earlier than in most developing countries, its achievements, at least measured in terms of the size of divestiture, have been limited compared with the principal Latin American and Eastern European cases. Between the starting point of the program in 1986 and August 2000, total proceeds of the Turkish privatization program have amounted to US \$7.1 billion, \$2.5 billion of which has been generated in the year 2000. This figure is considerably lower than the two major Latin American experiments involving hyperprivatization, in Mexico and Argentina.¹

Obviously, in measuring the performance of a privatization program, the size of divestiture does not constitute the sole criterion. In fact, hyperprivatization involving a massive sale of public assets to the private sector over a short time may be counter-productive. Mass privatization or

hyperprivatization may also fail to increase social welfare if public enterprises are disposed of at significantly less than their true market values or if public monopolies are transferred to the private sector in the absence of adequate regulation. With these reservations in mind, we hypothesize that the Turkish experience to date is characterized, with certain notable exceptional cases, by limited achievement, in terms of both the scale of the program implemented and the degree of realization of the basic efficiency objective.

Prior to the onset of large-scale privatization in 2000, the Turkish program has mainly involved the divestiture of relatively small and medium-scale public enterprises, especially in tradable goods sectors. The privatization of 29 cement factories, for example, generated sales revenues of almost US \$1 billion, around 13.5 percent of total privatization proceeds as of August 2000. Although the privatization of large-scale public enterprises has been continuously on the agenda, this rhetoric was not implemented. There have been cases where only minority shares of large enterprises have been transferred to the private sector. These sales may be important in magnitude, but do not provide a sufficient basis for a radical restructuring of managerial incentives needed to improve corporate efficiency.

Why has the Turkish privatization experiment been so protracted and limited in scope, at least until very recently, compared with both the relative achievements of the neoliberal program in Turkey—in such fields as trade and capital account liberalization—and the privatization records of other “emerging markets.”²² In addition to this question, this article also attempts to account for the recent resurgence of privatization in Turkey. From a comparative perspective, the Turkish case is interesting in identifying the type of variables that may facilitate or hinder privatization processes on a large scale. The Turkish example also demonstrates the difficulties of implementing privatization in a relatively open yet fragmented political system with a significant legacy of state interventionism.

Our central thesis is that the political, legal and institutional context and their mutual interaction are crucial in explaining the pace or success of implementing a privatization program. In the Turkish setting, a fragmented political system, characterized by a succession of weak coalition governments, has been instrumental in the delays and setbacks experienced by the privatization program. Within a fragmented polity,

newly established agencies responsible for the implementation of neoliberal reforms, such as the Privatization Administration (PA), fail to achieve the degree of autonomy needed to facilitate the program's rapid, effective implementation.

In this type of environment, intra-bureaucratic conflicts between established layers of the state (for example, the Constitutional Court) or the bureaucracy (for example, the Treasury or the Ministry of Finance) and the newly formed bureaucratic units emerge as a striking obstacle to the smooth implementation of the reform process. The Turkish experience also raises broader questions concerning the process of state restructuring that we observe in many late-industrializing countries undergoing reform experiences and also the problem of institution building and democratic accountability as central elements in carrying out welfare-augmenting privatization programs.

The analysis of the Turkish case also reveals the mechanisms that accelerate the pace of the privatization program. Certainly, obstacles to privatization should not be viewed in a static fashion. The recent resurgence of privatization in Turkey testifies that change is possible and is facilitated by the strengthening of executive authority through a more stable pattern of coalition politics as well as the establishment of the legal and institutional infrastructure by the late 1990s. What is also striking in this context is the critical role that external actors or influences can perform particularly in an environment characterized by acute fiscal disequilibrium.

Slow vs. Hyperprivatization

Institutions are important for the success of a privatization program. The effectiveness of institutions, however, is crucially dependent on the domestic and external environments in which they operate. Hence, a broadly based institutionalist framework is adopted which differs from a technocratic perspective, placing primary emphasis on the appropriate design of effective institutions. Within this overall framework, three general and interrelated hypotheses are advanced to account for the ability of certain countries to undertake large-scale privatization.

First, the presence of a strong executive authority with a deep sense of commitment to the implementation of the program constitutes a crucial influence. A strong executive is central to the implementation of the broad

macroeconomic, structural and legal-infrastructure reforms instrumental to the successful implementation of the privatization program itself. The presence of a powerful executive is also crucial in terms of breaking down opposition to the privatization program and allowing such key institutions as the privatization agencies a substantial degree of autonomy from interest groups both within and outside the state. Arguably, presidential government systems offer significant advantages compared to their parliamentary counterparts in this context.

The second crucial influence concerns the depth of the economic and political crises experienced by a given country prior to implementation of the program. It becomes much easier to implement a privatization program in a country that finds itself in the midst of a deep financial crisis. In such an environment, the power of external actors or constituencies for reform, such as the IMF or transnational business, increases considerably. Furthermore, in such an environment the executive authority enjoys greater autonomy and legitimacy for its underlying reform agenda.

Third, a favorable external context or the presence of a powerful external anchor provides an additional space for the state elites in which to maneuver and an extra impetus for rapid implementation. State elites or policy makers are able to legitimize the process and undermine opposition to reform when they are faced with a supportive international environment.

The relevance of this broad set of influences may be illustrated and highlighted with reference to key Latin American countries like Chile, Mexico and Argentina which have managed comprehensive privatization programs over a short space of time.³ The Chilean case is comparatively straightforward. A highly authoritarian regime under Augusto Pinochet, with a single-minded ideological commitment to the "free market," overrode political opposition and implemented a drastic privatization program. In the two larger Latin American economies, Argentina and Mexico, the hyperprivatization experiences of the late 1980s and early 1990s are somewhat paradoxical. Mass privatization has been accompanied by a process of democratization in Argentina and by some degree of political liberalization in the one-party dominant, semi-authoritarian political system of Mexico.

Both the Mexican and the Argentinean cases illustrate the importance of domestic political institutions, notably the role of presidential systems, in facilitating a drastic reform or privatization process. The patterns

observed in Argentina and Mexico are strikingly similar. In both cases, a strong president (Carlos Salinas in Mexico and Carlos Menem in Argentina), with unequivocal commitment to reform, provided an unusual degree of autonomous space to a group of technocrats, the so-called “technicos” associated with the centralized privatization agencies, to implement an ambitious program at an extraordinary pace.⁴

Consequently, the type of intra-bureaucratic, intra-state struggles characteristic of the Turkish case have largely been eliminated in both the Mexican and Argentinean settings. The Menem experiment in Argentina is particularly striking from a comparative perspective given that a “populist” politician, in the standard Peronist tradition with the strong backing of labor unions, has been converted into a neoliberal reformer. He has subsequently displayed—in radical contrast to his initial electoral platform—an unusual degree of commitment to the success of the privatization program. His personal popularity as well as the popular base of his political support proved to be critical in helping to build consensus around the reform project in the Argentine environment and provide legitimacy to the privatization program.

The presidential regimes in Latin America discussed above resemble the type of presidential or quasi-presidential regime that Turgut Özal tried to establish but could not institutionalize in Turkey, given the country’s strong traditions of parliamentary government, discussed more explicitly below. The link between a presidential system and the neoliberal program’s scale and pace highlights a serious dilemma. At least during a lengthy transition phase, a serious conflict seems to emerge between the two central objectives of establishing a “durable or high quality democracy” and a “truly free” market economy.⁵

In more concrete terms, the Latin American style of presidential politics, so dear to Özal during his final days, is quite different from the American presidential or the French semi-presidential regimes. In such systems, strong institutions and checks and balances limit the arbitrary exercise of power by the president himself. In Latin American systems, however, where institutional checks and balances are largely absent, the individual who occupies the presidential office embodies an unusual degree of authority and wide domain for personal power. The unique scope of authority bestowed upon the president can be a catalyst in initiating and sustaining a large-scale reform process. It is clear, however, that the system is not “democratic” by Western standards of liberal

democracy. Given the lack of appropriate checks and balances and presence of a highly concentrated presidential power, the environment may be better for hyperprivatization but also more open to abuses, including corruption.⁶ Indeed, the Brazilian example, a case of unusually slow privatization by Latin American standards, illustrates clearly how the misuse of presidential powers—creating public criticisms of abuses that force cutbacks in the program—can significantly block the momentum of the privatization process.⁷

As noted earlier, hyperprivatization may not necessarily imply “successful” or welfare-enhancing privatization. In fact, serious criticisms have been leveled concerning the quality of hyperprivatization in Argentina. The tendency to relegate fundamental issues pertaining to regulation and competition into the background—resulting in excessive concentration of economic power and low quality of services provided—have been frequently emphasized by those investigating the Argentina experiment. This has been particularly evident regarding telecommunications.⁸

Turning to our second broad explanatory category, the economic and political crises in Southern Cone countries have been much deeper than those experienced in Turkey. Mexico, for example, experienced virtually zero growth throughout the 1980s whereas Turkey recovered within two or three years from the major balance of payments’ crisis of the late 1970s, signifying the major crisis of import substitution in Turkey. Furthermore, the duration of authoritarian regimes and subsequent crises has been significantly longer in Southern Cone countries such as Argentina and Brazil. Judged by the intensity and duration of economic and political crises, therefore, the Turkish case may be characterized as a relatively stable case or an example of “stable instability.”

“The depth of crises” argument is important considering that Turkey has not experienced the type of crises which would provide the kind of “big push” needed to accelerate dramatically the pace of the privatization program. During the 1980s, leaders in Argentina and Mexico were paralyzed and unable to respond effectively to national problems. It took hyperinflation and a very serious economic crisis before the Argentine Congress passed laws giving sweeping powers to President Menem to privatize state enterprises. The depth of the crises and failures of previous authoritarian regimes in the economic realm have proved to be vitally important in Latin America in terms of securing legitimacy and generating

consensus around the reform and privatization program. For neoliberal reformers, it has been comparatively easy to override opposition in this type of environment.

As a third broad category, the “external anchor or discipline argument” is also directly relevant in the Latin American context, notably in the case of Mexico. Economic crisis seems to have played a large but less significant role there since other considerations, such as President Salinas’ desire to sign the North American Free Trade (NAFTA) treaty and Mexico’s special relationship with the United States acted as a source of external stimulus or discipline. This has been instrumental in accelerating the pace of the reform program in all areas including trade and capital account liberalization, macroeconomic stabilization and divestiture of state-owned enterprises. Stated somewhat differently, membership in NAFTA helped to augment the degree of autonomy of the domestic policy-making elite with respect to its own electorate. The rationalization of the reform process and the overriding of political opposition have been relatively smooth processes in the presence of such a powerful external anchor.

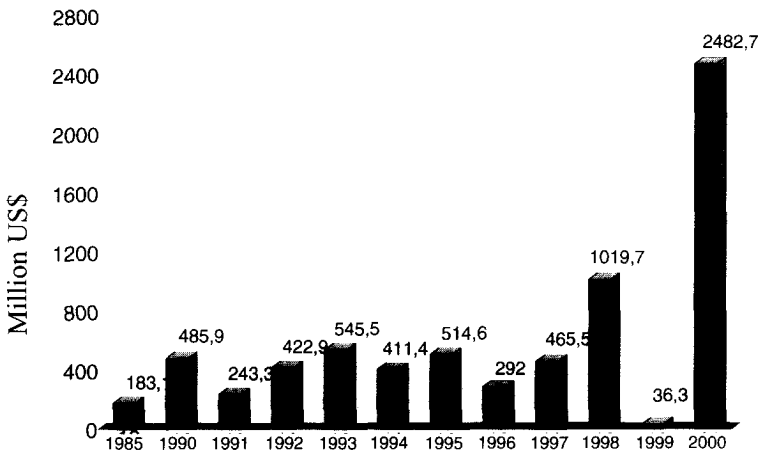
Turkish Privatization: Main Characteristics in the 1990s

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 before 1998 never exceeded the US \$600 million mark.⁹ The apparent major jump in privatization revenues in 1998, exceeding US \$1 billion mark, was 60 percent due to the sale of minority shares in İşbank, a privately owned major banking institution. In retrospect, 1998 might have been a major landmark in the history of Turkish privatization if the privatization of one major public enterprise, POAŞ (engaged in the distribution of oil) had materialized, an issue examined further in the subsequent section.

The year 2000, however, represented a major landmark in the history of Turkey’s privatization program. Almost US \$2.5 billion worth of privatization was concluded by 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.

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*.¹⁰ 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.¹¹

FIGURE 1
PRIVATIZATION IMPLEMENTATION ON AN ANNUAL BASIS (1985–2000)



Source: DPT (State Planning Organization), 1998 and Periodic Bulletin of the ÖİB (The Privatization Administration of Turkey), August 2000.

Although the privatization program effectively started in 1986, the legal framework for regulation was only established in October 1994, largely to meet the obligations imposed by Turkey's entry into the Customs Union with the European Union. The law at that time created the Competition Board, the key institution responsible for regulation, though it took additional time for it to begin effective operation.

The Board has been quite active in influencing Turkish privatization. A striking example took place regarding the proposed sale of POAŞ during late 1998 and early 1999, when the Competition Board challenged

the PA complaining it had not been consulted during the initial phase of the privatization process. Subsequently, the Competition Board effectively blocked the divestiture of POAŞ since the consortium initially interested in buying the enterprise declared they were no longer interested, allegedly because of the new constraints imposed by the Competition Board. The POAŞ affair clearly highlights the dilemmas experienced in Turkey in privatizing large-scale enterprises and problems for effective regulation and imposing rules of fair competition. Following this incident, however, the two key institutions developed far more effective cooperation, with the Competition Board actively and formally involved in the privatization process.¹²

Admittedly, to argue that regulation has been totally ignored, at least until very recently, would be an overstatement since during the program's early years, the "golden share" rule has been frequently practiced.¹³ 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 after privatization. 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. There exist well documented cases where the post-privatization company has abused its monopoly power because of the government's failure to implement effectively the golden share practice.¹⁴

A multitude of objectives 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.¹⁵ 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.

The Search for Strong Executive Authority

Politics within the state could act as a barrier to effective privatization. The architect of the Turkish privatization program, Turgut Özal, realized the need to create a powerful bureaucratic institution that would be directly tied to the prime minister's office while being largely independent from other key bureaucratic organizations responsible for economic policy making.¹⁶ The design of this powerful new institution proceeded in the following manner. First, Law No. 2983 set out the legal foundation allowing 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 bypassing possible constraints on the implementation of the program by the principal layers of the "classical bureaucracy" that arguably forms a "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 privileges after privatization.

It is also striking that the HDPPA, as a newly empowered state institution controlling the largest fund outside the regular government budget, 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 reminiscent of Latin American styles of decision-making, with a corresponding absence of checks and balances normally associated with a parliamentary form of governance. What was clearly intended is the creation of a highly centralized, 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 companies on the privatization agenda to the HDPPA itself. The institutional model developed rested on a division of labor between the executive (the prime minister) and the Privatization Administration, as the technical-bureaucratic unit with a 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, by assuming sole authority over the enterprise to be privatized, the PA 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, where the political scene during the 1990s was characterized by a highly fragmented party system and successive coalition governments.

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, despite their ideological differences, 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.¹⁷ 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.¹⁸

The lack of governance and commitment has been an obvious reason not only in the slow implementation of the privatization program, but also regarding tax reform, social security reform, and implementation of an overall disinflation program.¹⁹ 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 public-owned properties 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. Turkish politics is characterized by patronage politics.²⁰ Parties are typically clientist 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, the 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.²¹

The link between the political environment and the legal framework became critical to the fortunes of the privatization program in two 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—effectively exploited the absence of a privatization law until the enactment of a comprehensive 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 Özal favored decrees with the force of law in order to accelerate the pace of privatization and the overall reform process by overriding political or bureaucratic opposition. However, opponents of privatization have used the legal infrastructure's weaknesses as a way to block the progress of the program. "Politics within the state" is critical to this argument since the Constitutional Court, a key institution of the state apparatus's legal arm, has emerged as a critical institutional vehicle in creating obstacles for 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, 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 1990s was also 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, by an amendment to the Constitution itself. Yet this is a rather complex process because it requires a two-thirds majority in the Parliament, the achievement of which in the 1990s was an almost insurmountable task. The second-best solution was a privatization law conforming to the basic spirit of the Constitution. However, the enactment of such a law was not possible until 1994. Consequently, governments in power had to resort to a piecemeal 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 was passed and, to some extent, managed to overcome the legal framework's previous deficiencies. 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 used to meet the costs of divestiture, compensation of displaced labor and financial restructuring of enterprises in the PA's portfolio.²²

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 which the general privatization law proved to be inadequate. Strong opposition to telecom privatization manifested itself, on this occasion, as opposition to the Telecommunication Laws of 1994 and 1995. In particular, it was alleged that these laws did not conform to the basic principles of the Constitution. This criticism, in turn, was 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.²³

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 made in 1997. Finally, in 1999, the concept of privatization was incorporated into the Turkish Constitution as a by-product of accepting the rules of international arbitration.²⁴ The acceptance of the rules of international arbitration, 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 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 used this institution to block the momentum of the privatization process. It would be extremely misleading, however, to view the Constitutional Court in a totally negative light. This strong, independent institution helps avoid abuses of the privatization process, involving severe undervaluation of public assets for example. Such a safeguard reduces the ways in which hyperprivatization can be detrimental to welfare enhancement. 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, constitutionally compatible legal framework in a timely fashion.

The Privatization Administration in Critical Perspective

The PA's performance has heavily depended on the underlying commitment of a strong, autonomous political authority. In addition,

however, the institution has been characterized by a number of internal deficiencies, reflecting possible failures of its institutional design. The current organizational structure of the PA is clearly not commensurate with the complex, heavy workload imposed on the institution.

The organization is characterized by a top-down internal decision-making process, with excessive workload concentrated in the top management and limited avenues for delegation or decentralized decision-making. The operational effectiveness of the agency is significantly diminished by the unusually wide scope of the privatization program, with a disproportionate share of the public enterprise sector on the privatization agenda at any given time. In fact, the PA was responsible, as of August 2000, for the divestiture of 47 companies ranging from relatively small and medium-scale enterprises to such major operations as oil refineries, petrochemical concerns, iron and steel companies and national airlines. It also plays a pivotal role in the ongoing telecommunications privatization process.

A vicious circle emerges as slow privatization increases the agency's workload with additional public enterprises being placed on the already crowded privatization agenda. The absence of a delegated decision-making system manifests itself at two different levels. Neither lower level management within the agency itself nor the managers of the enterprises to be privatized can make a significant contribution to the decision-making process. Consequently, top managers became responsible for a disproportionate share of the decisions regardless of their significance for the overall program itself.

Another unintended outcome of this process is that top managers within the agency are not able to focus explicitly on certain key strategic issues. Perhaps the most obvious manifestation of the excessive workload phenomenon concerns the unusually long waiting periods between the time that an enterprise is placed on the privatization agenda (the preparatory stage) and the date of the final sale itself. As of August 2000, companies have been under the privatization portfolio for an average of 50.4 months. The preparatory stage is even lengthier for larger, more "visible" companies whose shares are traded on the stock market. For example, the oil-refining company (TÜPRAŞ) and the national airline company (THY) were incorporated into the privatization program in 1990 with limited success to date. Similarly, the integrated steel mill and producer of flat steel (ERDEMİR) and the petrochemical complex

TABLE 1
WAITING PERIODS IN THE CASE OF LARGE ENTERPRISES IN THE
PRIVATIZATION PROGRAM

Company	Industry Type	PA Share,%	Date of Incorporation (months/years)	Waiting Periods (years, months) (as of August 2000)
THY	Airline	98.17	08/90	10.00
TÜPRAŞ	Petroleum Refining	96.42	07/90	10.01
PETKİM	Petrochemicals	95.86	09/87	12.11
ERDEMİR	Iron and Steel	51.66	04/87	13.04
Average waiting period		(Years, months)	:	11.07

Note: Only small portions of these companies have been privatized.

Source: Periodic Report of ÖİB (The Privatization Administration of Turkey), August 2000.

(PETKİM) have been integral parts of the program almost right from the beginning, since 1987.²⁵ The average waiting period for such large companies has reached almost 12 years (Table 1).

The lengthy privatization process and lack of direction in the program have resulted in a deterioration of the financial strength of the enterprises to be privatized and hindered their vital expansion plans and marketing strategies. For example, until recently, the petrochemical complexes of PETKİM have not been allowed to undertake large-scale investment projects which are desperately needed to keep up with changing technologies and satisfy growing consumer demand. As a consequence of inadequate technological adaptation and slow expansion, the company's performance has arguably failed to reflect its true potential.

Rather paradoxically, some of the built-in strengths of traditional bureaucratic agencies have been strikingly absent in the PA. Indeed, one of the key problems confronted by the agency has been its inability to institute well-defined and objective recruitment procedures. The current recruitment system is based on political and personal connections. Ad hoc and arbitrary selection criteria have rendered the agency increasingly vulnerable to political pressures and external intervention. Heavy political involvement in the recruitment process is also reflected in the high turnover of top management. The PA has undergone major changes too frequently at the top management level (Table 2). Between 1993 and 1997, (acting) presidents have been able to serve for only 5.25 months on

average. It is rather striking that the PA has had more than three presidents and ten vice-presidents, on average, for each year in the past three years.²⁶ Since 1998, stability has been finally restored, with no change being observed in the top management

High turnover of top management clearly disrupts continuity and the accumulation of expertise. Rather ironically, stability of top management is more adequately secured in classical bureaucratic agencies that the PA was intended to bypass in the first place. For example, even the removal or the appointment of a middle manager (that is, a head of department) at the Treasury requires a decree signed by the president, prime minister and the relevant minister responsible for the institution. At an institution such as the Capital Markets Board (SPK), the chairman is appointed for a fixed term of three years, making it very difficult to remove him before the end of his term. On the other hand, in the context of the PA, both the president and the vice-presidents are vulnerable to the fast-changing political climate²⁷ The removal of the vice-president is even easier, left to the president of the PA and the minister in charge of privatization. The fragile nature of the appointment in the agency leads to frequent turnover of top personnel, leading to inertia and myopic bias.

One should also point out that the agency has inherited some built-in weaknesses of the existing bureaucratic order. Given civil service rules, no clear link could be established between performance and incentives. At present, an incentive system that allows a sharp differentiation between high and low performers is non-existent. This poses a real obstacle in terms of attracting highly motivated and qualified people to the agency. In other words, the agency faces the same problem of lack of accountability

TABLE 2
TOP MANAGEMENT TURNOVER IN THE PRIVATIZATION ADMINISTRATION

	1986–1993	1994	1995	1996	1997	1998**
Number of Presidents*	6	2	3	4	3	1
Number of Vice-Presidents	18	3	9	10	11	7

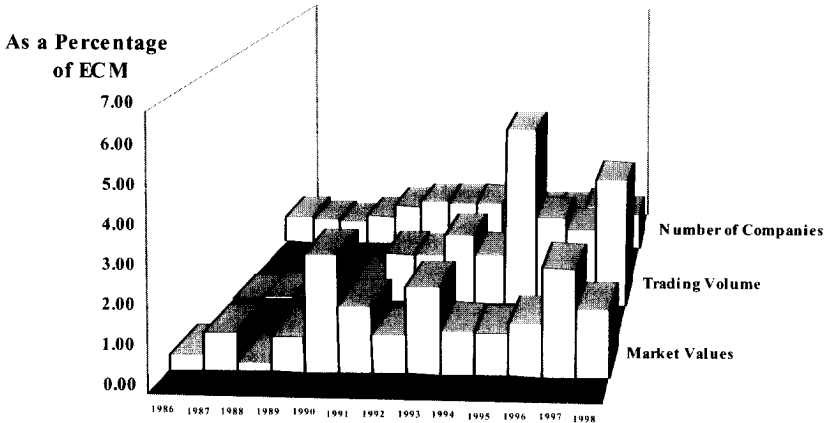
Note: If any president/vice president serves in different calendar years, he/she is counted in all corresponding calendar years.

*Between 1993 and 1997, the average tenure of presidents was 5.25 months.

**Since 1998, the PA has enjoyed a very stable pattern of top management

Source: The Privatization Administration of Turkey, Prime Ministry of Turkey

FIGURE 2
THE RELATIVE SIGNIFICANCE OF THE ISTANBUL STOCK EXCHANGE
IN THE EMERGING CAPITAL MARKETS (ECM) (1986-98)



Source: IMKB Dergisi, Istanbul Stock Exchange, Vol.3, No.10, pp.55-8.

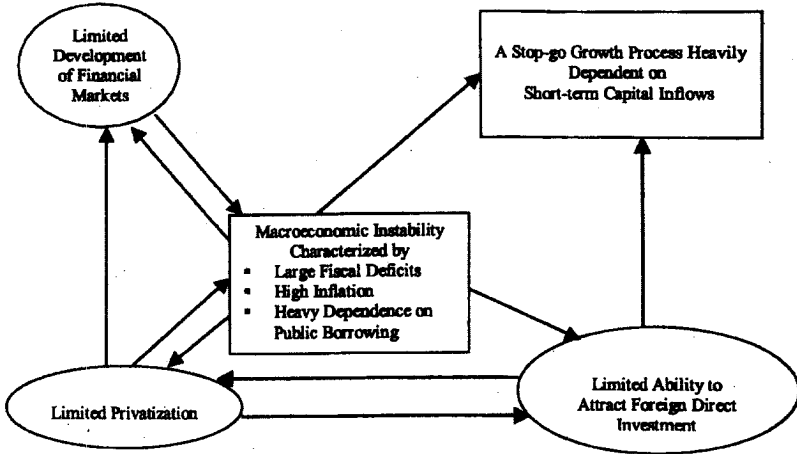
that is a characteristic of the bureaucratic structure as a whole. Clearly, attempts to improve performance are severely undermined in the absence of sufficient accountability in the system. All in all, high turnover of top management coupled with lack of accountability, results in perverse incentives.

Macroeconomic Instability and Slow Privatization

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.²⁸ Empirical evidence for this assertion is provided by a study covering the 1989-93 period, during which 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.²⁹

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

FIGURE 3
THE VICIOUS CIRCLE OF MACROECONOMIC INSTABILITY
AND LIMITED PRIVATIZATION IN TURKEY



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 (Figure 2). 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.³⁰ 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 (Figure 3). However, a major qualification is called for 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.³¹

It is clear that a major breakthrough in the privatization effort possesses 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.³²

Resurgence of Privatization in Turkey: A Paradox?

It is interesting to observe that privatization finally gathered momentum during 2000. Two major cases were involved: 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, with a greater degree of stability and less conflict than its predecessors experienced on a regular basis. A more stable pattern of coalition politics, in turn, resulted in greater stability in the Privatization Administration itself (Table 2). Another favorable sign in this respect was that after significant delay, the legal and institutional infrastructure of privatization was largely 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 that 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 government had to speed up the privatization process not because of profound ideological convictions 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.

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 January 24, 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.

Concluding Observations

Institutions have a significant bearing on the ability of countries to implement privatization programs. Institutions, however, do not exist in a vacuum. The effectiveness of bureaucratic institutions depends critically on the domestic political and economic environment as well as the influence of external actors. This suggests that a mere creation of a new institution is not enough to ensure effective privatization implementation. The Turkish privatization program has certainly been negatively affected by the lack of political stability and the associated intra-state or intra-bureaucratic conflicts aggravated by a fragmented political system. The

critical agency responsible for the implementation of the privatization program in Turkey, the Privatization Administration (PA), was largely designed on the assumption that a quasi-Latin American style presidential government could be institutionalized in the Turkish context during the late 1980s. Lack of political stability at the level of the broad macro environment, however, has meant lack of continuity in the direction of the PA itself. Consequently, the 1990s have been characterized by an unusually rapid turnover of top managerial personnel at this critical institution. Delays in privatization, in turn, had undesirable repercussions on the performance of public enterprises placed on the privatization agenda.

The privatization program in Turkey has suffered from the deficiencies of the legal framework, which have subsequently been remedied to a certain extent, but with a major time lag. The weaknesses of the legal framework strengthened the position of those groups who were against privatization in principle. In fact, one of the striking features of the Turkish experience is that a number of privatization cases have been explicitly challenged at the Constitutional Court. This has resulted in the reversal of a series of some key privatization decisions.

The strength of the executive authority in itself is a critical factor in facilitating large-scale privatization. The Turkish case illustrates, however, that two other fundamental factors—the threat of a major economic crisis coupled with pressure from external actors—may provide a major impetus for the privatization program by strengthening the executive's hand even when its underlying power may not necessarily be greater than before.

Economic crises tend to undermine opposition to reform and strengthen the executive's hand even if its formal power is not extended. The emergency situation and the failure of alternatives that typically accompany an impending or actual major crisis tends to provide legitimacy to the privatization program as well as enhancing the degree of governmental coherence. The relative power and influence of key external actors, such as foreign investors or the IMF, who are members of the pro-privatization coalition are strengthened considerably in the process.

Finally, a major lesson to be drawn from the Turkish experiment concerns the critical role that the external environment, with its multiple constituencies, can play in terms helping to break down resistance to reform in the domestic sphere and render a resurgence of privatization

possible. Particularly significant in this context is the pressure from the external financial community, the transnational corporations and a supranational entity such as the European Union in creating the legal and institutional infrastructure of privatization which at the same time weakens the power of interest groups naturally opposed to reform. The mix of conditions and incentives embodied in IMF programs, the Customs Union Agreement with the European Union and prospects of full EU membership have all played an instrumental role in the recent resurgence of privatization in Turkey.

NOTES

1. According to the data provided in Ramamurti (1999), proceeds from privatization during the period 1988–98 for Argentina and Mexico have been estimated at US \$18.25 billion and US \$27.32 billion, respectively. See Ravi Ramamurti, "Why Haven't Developing Countries Privatized Deeper and Faster?" *World Development*, 27 (1999), pp.137–55.
2. An overall assessment of the Turkish neoliberal experiment, focusing on the depth of the reform process and degree of success achieved, is an issue that is beyond the scope of this contribution. It is quite clear, however, that much more progress has been achieved with respect to trade and capital account liberalization compared with privatization. For broad evaluations of the Turkish liberalization process during the 1980s and the 1990s, see: Tosun Arıcanlı and Dani Rodrik, "An Overview of Turkey's Experience with Economic and Structural Adjustment," *World Development*, 18 (1990), pp.1343–50; Dani Rodrik, "Premature Liberalization and Incomplete Stabilization: The Özal Decade in Turkey," in M. Bruno *et al.* (eds.), *Inflation and Stabilization* (Cambridge, MA: MIT Press, 1992), pp.323–58; Sübidey Togan, *1980'li Yıllarda Türk Dış Ticaret Rejimi ve Dış Ticaretin Liberalizasyonu* (Ankara: Eximbank Publishers, 1993); Ziya Öniş, *State and Market: The Political Economy of Turkey in Comparative Perspective* (Istanbul: Boğaziçi University Press, 1998); Korkut Boratav, Erineç Yeldan and Ahmet H. Köse, "Globalization, Distribution and Social Policy: Turkey 1980–1998," (mimeograph, Faculty of Political Science, Ankara University and Department of Economics, Bilkent University, 1999).
3. On some of the underlying causes of the slow pace of privatization in the developing world, see Ravamurti (1999). For detailed assessments of privatization programs implemented in the Southern Cone, see Pedro Aspe, *Economic Transformation the Mexican Way* (Cambridge, MA: The MIT Press, 1993); Luig Manzetti, "The Political Economy of Privatization through Divestiture in Less Developed Countries," *Comparative Politics*, 25 (1993), pp.429–54; John Waterbury, *Exposed to Innumerable Delusions, Public Enterprise and State Power in Egypt, India, Mexico and Turkey* (New York: Cambridge University Press, 1993); Judith Teichman, "Mexico and Argentina: Economic Reform and Technocratic Decision Making", *Studies in Comparative International Development*, 32 (1997), pp.31–55. For an important attempt to discuss the relationship between democratization and economic reforms in Latin America from a cross-regional perspective, see Pereira Bresser, Luis Carlos, Juan M. Maravall and Adam Przeworski, *Economic Reforms in New Democracies, A Social Democratic Approach* (New York: Cambridge University Press, 1993).
4. On the importance of the presidential system in terms of allowing the small technocratic elite to undertake drastic economic reform, see Aspe (1993), Manzetti (1993), Miguel Angel Centeno, *Democracy without Reason: Technocratic Revolution in Mexico* (University Park, PA: The Pennsylvania State University Press, 1994); George Philip, "The New Populism, Presidentialism and Market-Oriented Reforms in Spanish South America," *Government and*

- Opposition*, 33 (1998), pp.81–96; Teichman (1997); Kurt Weyland, “Neo-liberal Populism in Latin America and Eastern Europe.” *Comparative Politics*, 31 (1999), pp.379–401.
5. For an interesting discussion of whether the “capitalist revolution” in Latin America will succeed in creating a genuinely “free and competitive market economy,” free from clientelistic ties and based on respect for the rule of law, see Antonio Vargas Llosa. “A Capitalist Revolution in Latin America?” *Critical Review*, 12 (1998), pp.35–49. Many of the points raised by Llosa concerning the limitations of the “capitalist revolution” in Latin America are also applicable to the Turkish case where clientelistic networks also continue to constitute a strong feature of the political system.
 6. The issue of insufficient political accountability emerges as a serious problem in many emerging democracies and contains serious ramifications for the effectiveness of a privatization program from a social welfare point of view. Weyland (1999), in particular, emphasizes the important point that Latin American style presidential regimes may be quite effective in terms of initiating a process of radical economic reforms but considerably less successful in terms of consolidating or institutionalizing such reforms.
 7. The Brazilian example clearly demonstrates how the strong institutional autonomy that a Latin American style president enjoys may not be sufficient for the success of privatization. The quality of leadership also matters. Presidential autonomy fails to produce the desired benefits in the absence of adequate leadership, an observation that is clearly verified in the Brazilian case. The Brazilian president, Fernando Collor de Mello, was involved in a major corruption scandal, which became public in May 1992. This, in turn, represented a severe blow to the fortunes of the privatization program. For a comprehensive account of Brazil’s struggles with state reform and the fortunes of the Collor Administration, see Louiz Carlos Bresser Pereira, *Economic Crisis and State Reform in Brazil. Towards a New Interpretation of Latin America* (Boulder & London: Lynne Rienner Publishers, 1996).
 8. For a penetrating discussion concerning the limitations of the Argentine privatization experiment and especially the problems encountered in the aftermath of telecom privatization, see Manzetti (1993).
 9. The Turkish privatization experience to date has been extensively studied. For a small sample, see Ziya Öniş, “The Evolution of Privatization in Turkey: The Institutional Context of Enterprise Reform,” *International Journal of Middle East Studies*, 23 (1991), pp.163–76; Coşkun Can Aktan, “The Privatization of Public Enterprises in Turkey,” *Boğaziçi Journal*, 7 (1993), pp.39–52; Cevat Karataş, “Privatization and Regulation in Turkey: An Assessment,” *Journal of International Development*, 4 (1993), pp.583–605; Merih Celasun and İsmail Arslan, “State Owned Enterprises and Privatization in Turkey: Policy, Performance and Reform Experience: 1985–93,” *ERP, Working Paper* (1997), No.9709; Metin Ercan, “Efficiency of Institutions and the Privatization Process: The Turkish Privatization Administration in Critical Perspective,” presented at a Conference organized by the United Nations, Economic and Social Commission for Western Asia, Beirut, Lebanon. (1997); “Recent Privatization Program in Turkey,” *Institutional Turkey*, (2000); Özer Ertuna, “Lessons from Turkish Privatization Experience” (mimeograph, Department of Management, Boğaziçi University, Istanbul, 1997); Cevat Karataş, “Privatization in Turkey: Implementation, Economic Environment and Performance Results.” (mimeograph, Institute for Development Policy and Management, University of Manchester, 1999). For a valuable study of the process of privatization in the cement industry and the problems encountered in the aftermath of privatization, in the form of growing concentration of economic power, see Drury Tallant, “Relative Efficiency of Public and Private Sector Ownership and Privatization of Turkish Cement Industry,” *Boğaziçi Journal*, 7 (1993), pp.73–103. For an official assessment of the Turkish privatization experience to date, see Devlet Planlama Teşkilatı (DPT), *Türkiye’de Özelleştirme Uygulamaları, 1984–1998* (Ankara: State Planning Organization, 1998).
 10. On the importance of competition and regulation for welfare-enhancing privatization, see John Vickers and George Yarrow, “Economic Perspectives on Privatization,” *Journal of*

Economic Perspectives, 5 (1991), pp.112–32.

11. On the objectives of the Turkish privatization program, see Morgan Guaranty Bank, *Privatization Master Plan: SOEs Recommended for Sale, Action Plans* (Ankara: Morgan Guaranty Bank for the State Planning Organization, 1986), a report specially commissioned by the Turkish government.
12. The role of the Competition Board in the privatization process of POAŞ, eventually resulting in the collapse of the proposed sale has been widely documented in the national press. See, among others, “Garanti-Doğuş POAŞ’tan çekildi” *Radikal*, (National Newspaper) March 3, 1999. The conflict between the PA and the Competition Board was openly admitted by the Chairman of the Competition Board at the time. See “6 metrekarelik mutluluk,” *Star* (National Newspaper) May 29, 1999.
13. For a good discussion of the “golden share” practice as a means of regulating enterprises in the post-privatization era, see Karataş (1993).
14. Abuses of monopoly power, in the absence of adequate regulation, have been observed both following the sales of USAŞ, an airplane catering company and ÇİTOSAN, a cement firm. For evidence on this issue, see Karataş (1993) and Tallant (1993).
15. The acute fiscal disequilibrium experienced by Turkey, notably during the 1990s, has been extensively analyzed. Particularly significant among a multitude of studies are the following: Fatih Özatay, “The Lessons from the 1994 Crisis in Turkey: Public Debt (Mis)Management and Confidence Crisis,” *Yapı Kredi Economic Review*, 7 (1996), pp.21–37; İzak Atiyas and Şerif Sayın, “A Political Economy Perspective on Turkish Budget Deficits,” *Boğaziçi Journal*, 12 (1998), pp.55–80; Boratav *et al.* (1999). On the emergence of revenue considerations as the primary objective of the privatization program in Turkey, see Sven Kjellstrom, “Privatization in Turkey,” *World Bank Working Paper Series*, 532 (1990), and Aktan (1993).
16. Turgut Özal was the Prime Minister of Turkey during the 1983–89 period and the President from 1989 until his death in 1993. Concerning Özal’s objective of instituting a type of strong presidential system, with an unusual concentration of executive power, to overcome the constraints imposed by the “classical bureaucracy” and his intention to undermine the power of the “traditional bureaucratic elite” in Turkey, to restore the balance between elected politicians and life-time bureaucrats, see Mehmet Barlas, *Turgut Özal’ın Anıları* 2nd edn. (İstanbul: Sabah Kitapları, 1996). On the broad political economy of Turkey in the post-1980 era, notably on the dominance of the right-of-center Motherland Party (ANAP) during the late 1980s followed by a period of unstable coalition politics in the 1990s, see John Waterbury, “Export-Led Growth and the Center Right Coalition in Turkey,” *Comparative Politics*, 24 (1992), pp.127–45; and Öniş (1998).
17. In the first half of 1989, 90 percent of the state’s equity in the large cement firm ÇİTOSAN was sold to Société Ciment Français, and 70 percent of USAŞ, an airline catering service, was sold to Scandinavian airlines. Subsequently, the Constitutional Court in response to the formal demands of the two opposition parties DYP and SHP, blocked the sales of ÇİTOSAN and USAŞ on the grounds that sales of public enterprises to foreigners were unconstitutional.
18. Some striking examples involving the reversal of privatization decisions are EBK (meat processing), SÜMERBANK (banking institution) and PETLAS (manufacturer of tires). Most of the companies experiencing a reversal decision have subsequently been privatized.
19. There is renewed ground for optimism concerning Turkey’s ability to implement privatization and overall macroeconomic reform following the formation of a new coalition government after the general elections of April 1999. For a discussion of this renewed optimism, see Ziya Öniş, “The Turkish Economy at the Turn of a New Century: Critical and Comparative Perspectives”, in Morton Abramowitz (ed.), *The Turkish Transformation and American Policy* (Washington, DC: The Century Foundation, 2000), pp.95–115.
20. For a valuable discussion of patronage politics, clientelism and the nature of party politics in Turkey see Ayşe Güneş-Ayata, “Roots and Trends of Clientelism in Turkey”, in Luis Roniger and Ayşe Güneş Ayata (eds.), *Democracy, Clientelism and Civil Society* (Boulder & London:

- Lynne Rienner, 1994); and Metin Heper and Fuat Keyman, "Double Faced State: Political Patronage and the Consolidation of Democracy in Turkey", *Middle Eastern Studies*, Vol.34, No.4 (1998), pp.259–77.
21. Allegations concerning corruption in privatization deals have been frequently advanced by the national press. Striking examples of such allegations include the sale of minority shares in TOFAS to foreign investors. However the allegations could not be substantiated through a court decision. Frequent allegations of insider trading involving manipulation of stock prices through false announcement and abuse of market-making power have been advanced during the early stages of the privatization program, notably in the context of public offerings. One ought to remember that during privatization of the major bank, TÜRKBANK, the government in power collapsed following revelations involving the government's alleged behind-the-scenes dealings with a potential bidder. This case constituted the most striking case of alleged corruption involving privatization deals in Turkey.
 22. For a good discussion of the Privatization Law of 1994 and its implications for the subsequent course of privatization in Turkey, see Celasun and Arslan (1997).
 23. For a critical assessment of the Turkish privatization experience in the field of telecommunications from a comparative perspective with a specific focus on the legal framework, see Funda Başaran and Önder Özdemir, *Telekomünikasyonda Özelleştirme* (Ankara: KİGEM, 1998).
 24. The constitutional amendment was finally made by securing the long awaited two-thirds majority needed.
 25. The enterprises concerned are currently among the largest manufacturing establishments in Turkey. For example in 1998, according to the largest 500 industrial establishments in Turkey survey, published by the Istanbul Chamber of Industry, TÜPRAŞ is ranked first, ERDEMİR is seventh and PETKİM is tenth. One should note that a very small proportion of shares of these enterprises have been sold to the public and these sales have been accomplished in the early stages of the program with little or no progress in the subsequent periods. Yet, the proportion of shares sold of the total equity of the enterprises concerned remains unusually low. Currently, the highest percentage is recorded in the case of PETKİM (4.14 percent). The corresponding figures for TÜPRAŞ, THY and ERDEMİR are 1.64, 1.55 and 2.93 percent, respectively. For evidence, see DPT (1998).
 26. In 1996 alone four presidents were in office.
 27. Between 1996 and 1997, three governments were formed. During the period concerned, all presidents and almost all vice-presidents of the PA were removed from the office right after the new government received the vote of confidence from parliament.
 28. Ertuna (1997).
 29. Bengi Özer, "Price Performance of Initial Public Offerings in Turkey" (Ph.D dissertation, Boğaziçi University, Istanbul, 1995).
 30. For evidence on the persistence of macro-economic instability in Turkey during the 1990s and investigations of the underlying causes of this instability, see Özatay (1996); Atiyas and Sayın (1998); Öniş (1998 and 2000); Boratav *et al.* (1999); Nurhan Yentürk, "Short-Term Capital Inflows and their Impact on Macro Economic Structure: Turkey in the 1980s." *The Developing Economies*, 32 (1999), pp.89–113.
 31. The stop-go pattern of economic growth which heavily relies on inflows of short-term external capital in response to high domestic interest rates have been analyzed, among others by Öniş (1998) and Yentürk (1999).
 32. For evidence on a positive relationship between privatization, efficiency and economic growth, see J. Galal, L. Tendon, P. Tendon and I. Vogelsang, *Welfare Consequences of Selling Public Enterprises: An Empirical Analysis* (New York: Oxford University Press, 1994). The authors are careful to emphasize, however, that the context in which privatization is engineered is crucial to subsequent economic performance. Much will depend on how the sale is transacted, the market structured and the firm regulated.

Recent Privatization Experience of Turkey - A Reappraisal

İzak Atiyas

INTRODUCTION

Privatization was placed on Turkey's economic policy agenda as early as mid-1980s. At the time, privatization was seen as an important component of the structural adjustment process that was intended to move the economic policy regime away from the import substitution model that prevailed in the earlier decades towards a model where markets and the private sector would play a predominant role in economic activities. Policymakers presented privatization as a way to increase overall efficiency of the economy, reduce public expenditures, transform what were seen as inefficient public enterprises, reduce the scope of the state, develop domestic capital markets and widen share ownership by the general public.

Despite the rhetoric, though, there seems to be a general consensus that the Turkish experience with privatization in the 1980s and 1990s has not lived up to expectations. Indeed during this period privatization revenues have been quite low, of the order of about \$500-600 million per year (see Figure 1 below). Several arguments have been proposed for this outcome, including weak commitment by coalition governments, disagreements among coalition partners about the desirability and scope of privatization, concern at the political level about loss of patronage opportunities, the ability of the étatist-minded state elite to use

the recourse to the constitutional court to launch legal challenges against privatization laws and that the general public was not yet altogether agreeable to the notion of privatization.¹

The privatization scene has changed significantly since the year 2000, and more dramatically since 2004. A number of large enterprises have been privatized and more than \$26 billion have been raised in privatization revenues between 2005-2008 (Figure 1). Perhaps more importantly, privatization has moved to infrastructure industries such as telecommunications, electricity and ports. These are industries with endemic problems of imperfect competition and market power and, from a public welfare point of view, pose special problems in terms of privatization policy.

The purpose of this chapter is to assess of Turkey's recent experience with privatization. The chapter will try to examine the factors that may explain the rapid increase in privatization activity and evaluate recent privatizations from a normative point of view. The main conclusions of the chapter are as follows: First, by the end of the 1990s, a more or less coherent legal framework for privatization, consistent with the constitutional interpretations of the Constitutional Court was in place. Second, the single-party governments of the 2000s were both more enthusiastic about privatization and had strong incentives, given the rigid fiscal adjustment that the country had to go through in the aftermath of the 2000-2001 crisis. Third, even though on paper privatization policy had a multitude of objectives, and even though in some industries (most notably electricity and telecommunications) privatization was accompanied by the development of a regulatory framework to prevent anti-competitive abuses, in practice the objective of revenue generation dominated privatization transactions

¹ There is now an extensive literature on the Turkish experience with privatization in the 1980s and 1990s. See especially Karataş (1993, 2001), Oniş (1991), Ercan and Oniş (2001), Celasun and Arslan (2001) and Ökten (2006).

and long-term-productivity was given much lower priority. In fact, governments have seen privatization-at-all-costs as a panacea in itself, and treated it as a substitute of good public policy at the sectoral level, especially in infrastructure industries.

The chapter is organized as follows. The next section will provide a brief overview of recent experience with privatizations. Next, the chapter will summarize the evolution of the legal infrastructure of privatization. The relation between competition policy, regulation and universal service obligations, and their role in privatizations will be discussed next. The chapter will then present a more detailed analysis of privatizations in infrastructure industries. The last section will provide a summary assessment and conclude.

RECENT EXPERIENCE

Figure 1 presents the evolution of privatization revenues over time. Until 2004, with a few exceptions discussed below, privatization revenues have been quite low, around or below \$ 500 million per year. Indeed, in the 1990s privatization consisted of manufacturing establishments primarily in the food, beverages, electronics, and cement industries. In the 1990s there were also a number of public offerings of large state-owned companies, comprising typically a small proportion of total equity (between 2-8 percent), including: Erdemir (steel, 1990), Petkim (petrochemicals, 1990), Tüpraş (refinery, 1991), Petrol Ofisi (retail gasoline, 1991). However, the sale of controlling shares in these companies to the private sector took place in 2000 and after. One exception was the year 1998, during which Etibank, a bank originally established to finance mining activities, was privatized in a block sale and government's share in İş Bank was privatized through a public offering.

FIGURE 1 NEAR HERE

In 2000, another exceptional year, there were a few big ticket items. One was the block sale of Asil Çelik which was a steel company originally owned by the Koç Group and taken over by the government when it fell into financial distress. The second was the block sale of Petrol Ofis, a gasoline retailer, and the public offering of 31 percent of the share of the petroleum refinery Tüpraş. Table 1 gives the dates and sales values of privatization transactions with values over \$ 100 million. It also presents cases where the divestiture of a company was done in stages.

TABLE 1 NEAR HERE

But the real sustained increase in privatization revenues started in 2004. Privatization revenues exceeded \$ 8 billion annually in 2005-2006 and averaged almost \$5 billion in 2007-2008. The privatized companies were truly the state-owned giants of the economy, including Turkish Airlines, Tüpraş, Erdemir, Türk Telekom, the incumbent telecommunications operator, a number of ports including some of the largest in Turkey, electricity distribution companies and Tekel, the tobacco and cigarette company. One should underline the recent move towards infrastructure facilities and companies engaged in the provision of what many countries regard as public services.

Table 1 also indicates that, except for the case of Turkish Airlines, majority shares in most companies have been divested through block sales rather than public offerings. As has been emphasized before (e.g. Karataş 2001), widening of share ownership, an objective that was

heavily emphasized in the beginning of the privatization adventure seems to have been largely forgotten. Even though this could be due to constraints imposed by underdeveloped and shallow capital markets, it could also reflect the governments' desire to ensure the presence of strategic investors with secured control rights, that is, a non-dispersed form of corporate governance. Especially in cases where the interests of the shareholders require that the company goes through significant restructuring, and that the influence of politically appointed insiders be reduced, dispersed ownership may hinder such changes and strengthen the current management instead. Lack of control rights, of course, would also potentially reduce the expected privatization revenues.

EVOLUTION OF THE LEGAL INFRASTRUCTURE

The evolution of the legal infrastructure for privatization provides interesting clues both about the politics of privatization and about reasons behind the contrasting performance between the 1990s and 2000s. The first set of legislation on privatization of state-owned or affiliated assets were Law no. 2983 ("Law on the encouragement of savings and acceleration of public investments") and decree with the force of law (Decree-Law for short) no. 233 (decree-law on state economic enterprises), both adopted in 1984. The former authorized the administration to issue "revenue sharing certificates", equity shares and operating rights on public facilities. It also created Mass Housing and Public Participation Board (MHPPB). Decree- Law 233, on the other hand, was really a piece of legislation that laid down a new legal and organizational framework for state owned enterprises, but article 38 identified various forms of divestiture (namely liquidation, transfer, sale and granting of operating rights). These transactions would be carried out by the MHPPB. Because of the inadequacy of these pieces of legislation, in 1986 law no. 3291 was enacted. This was the first law where the word privatization was

explicitly used. This law made the Council of Ministers responsible for the privatization decision of state economic enterprises (SEEs), and the MHPPB of organizations where SEEs had shareholdings. Law no. 3291 remained as the main privatization law until 1994. However, this law also suffered from a number of weaknesses. It was primarily an amendment law, not a coherent privatization law. Its provisions on privatization consisted merely of some 4 articles and they were very general. The concepts used were vague and in implementation it turned out they were very inadequate. Its provisions for the treatment of employees did not cover all employees of the enterprises under privatization and this created significant rigidity. The whole process placed highly burdensome responsibilities on the agencies responsible for privatization for the governance of enterprises admitted into the divestiture process (Baytan 1999: 37, Celasun and Arslan, 2001:241).

Governments tried to reassign decision making authorities on privatizations through a number of laws and decree-laws in the period 1990-1994.² As a result of these, the legal basis of privatization became even more complex and disorganized. In 1994 Turkey suffered from a severe currency crisis. Right after the crisis, the government attempted to resolve the privatization quagmire through decree-laws and enacted the “enabling law” 3987. This law did not address privatization directly, but intended to give the government the authority to issue decree-laws. The government issued five decree-laws on the basis of Law 3987, on organizational issues as well as labor compensation schemes. The law was taken to the Constitutional Court by the opposition party members and cancelled by the Constitutional Court. Finally, Law 4046, which still governs the privatization process in Turkey, was enacted in October 1994.

² To be exact, four decree-laws (number 304, 414, 437 and 473) and one law (no. 3701) (Baytan 1999: 38). Just to give an example of the degree of confusion, law No. 3701 was adopted on 6 March 1991, and was annulled through decree-law 437 only four months later, on 17 July 1991.

The reason for revisiting this history is to underline the fact that governments in the late 1980s and early 1990s did spend quite a bit of effort to enact laws that would enable them to proceed with privatizations. However, the laws that they enacted looked for shortcuts rather than create a solid legal base for a privatization policy.³ The laws typically gave substantial discretionary authority either to the government or to administrative agencies, and provided little detail on definitions, procedures, methods to be used for privatizations, let alone taking into consideration potential problems that might arise in industries where market power existed. They were designed to undertake privatizations in quite unaccountable and non-transparent ways. Perhaps more importantly, however, these efforts reflected an inadequate understanding of the legal complexities of privatization of state owned assets. Either there was a steep learning curve to go through, or politicians and bureaucrats engaged in designing these laws lacked the capacity to comprehend and deal with these complexities or both.

It is also interesting to review the main concerns raised by the Constitutional Court in its decision to cancel Law 3987. The main points of the Court included the following (Atiyas and Oder 2005: 55-57).

a) Law 3987 gives the Council of Ministers the authority to issue decree-laws with almost no limitations. This amounts to the delegation of legislative authority to the executive and is not constitutional.

³ Note also that this effort spanned different governments: The ANAP government headed by Turgut Özal (1983-87), during which laws no 2983, 3238 and 3291 as well as decree-law 233 were enacted, and the DYP-SHP coalition government headed first by Süleyman Demirel and then by Tansu Çiller (1991-1995) during which laws 3987 and 4046, as well as numerous decree-laws were enacted.

b) The transfer of control over public services that have strategic value such as telecommunications and electricity to foreigners is unconstitutional

c) The privatization of natural monopolies would create private monopolies. This is unconstitutional. In case of such privatizations, it is necessary to show what sort of measures will be undertaken so as to allow the state to exercise oversight and control.

The first item reflects that the Constitutional Court would like to have the legislature specify ex-ante and in some detail the authorities of the executive and administrative agencies and the procedures they are going to use when they conduct privatizations. Put differently, the Constitutional Court revealed a preference for less discretion and higher legal certainty at the executive and administrative levels. The concern reflected in the second item has been met by allocating the government a “golden share” in privatizations where the government loses majority control of a strategic enterprise. Such golden share would give the government a say in and authority to approve critical decisions (say changes in the articles of association or mergers with other companies).⁴ The third item is perhaps the most interesting: it is simply stating that privatization of natural monopolies should be carried out only if a regulatory framework is established to curb the abuse of market power. This, of course, is consistent with standard normative economic theory of privatization (see below).

When the efforts to change the legal framework of privatization through decree laws was struck down by the Constitutional Court, the government finally put together and enacted Law

⁴ This, for example, has been the case in the privatization of Türk Telekom. For other examples, see Karataş (1993).

4046 (henceforth Privatization Law) which was a comprehensive and detailed law governing privatizations.⁵

The Privatization Law went through some further changes before it reached its final form. Importantly, in a decision annulling some articles of the law, the Constitutional Court required that the determination of the details of tender and valuation methods should not be delegated to administrative agencies but should be specified in the law, reiterating its preference for less discretion mentioned above. These details have been added to the law in 1997 through the adoption of Law 4232. Hence by the end of the 1990s, after a long and convoluted process, a legal basis for a workable privatization policy, and more or less consistent with the constitutional interpretations of the Constitutional Court was established.

PRIVATIZATION AND WELFARE: THE ROLE OF COMPETITION, REGULATION AND DISTRIBUTIONAL CONCERNS

Privatization has been a controversial policy worldwide. Survey results indicate, for example, that in Latin America initial support for privatization has decreased over time (Estache and Trujillo 2008: 137-8). More generally, in many countries privatization has been criticized for their adverse distributional consequences (Roland 2008:1). The literature that attempts to measure the effects of privatization provides mixed conclusions. Initial estimates of large improvements in the performance of privatized enterprises seem to suffer from sample selection bias (more profitable firms are privatized first, hence efficiency gains may be resulting not from privatization but from the fact that they were efficient to begin with). In

⁵ See Ercan and Onis (2001) and Karataş (2001) for more information on the law.

any case, one important conclusion that emerges from this literature is that in imperfectly competitive industries consequences of privatization critically depends on the institutional environment, especially in the existence of good regulation.

Indeed, the most important consequence of privatization is likely to make firms more responsive to profits: that is, privatization encourages profit maximization. Whether this is good or bad largely depends on market structure and the legal and institutional environment. It would be fair to say that economic theory would support a presumption that in the absence of market failures such as externalities, public goods, imperfect information and imperfect competition, and in the absence of distributional considerations (for example universal service) profit orientation would result in an increase in allocative and cost efficiency, and overall welfare. By contrast, the consequences of privatization are not obvious when either market imperfections exist or when social welfare includes distributional concerns, for example in the form of universal service obligations.

Competition Policy vs. Regulation

In the Turkish context, imperfect competition has been an important source of market failure that the privatization process has faced, especially in infrastructure industries such as telecommunications, electricity and ports. One might question why the existence of imperfect competition should pose a special problem for privatization, as long as competition law exists and is effectively enforced in the country. Indeed a legal and institutional framework for competition law enforcement does exist in Turkey. The Law on The Protection of Competition was enacted in 1994 and the Competition Authority has been enforcing the law since 1997. Moreover, competition law enforcement is one area of public policy where

Turkey is regarded to be relatively successful.⁶ In fact, as will be discussed in more detail below, the role of the Competition Authority in privatizations in Turkey has been quite important thanks to procedural requirements that allow the Competition Board to voice its opinions and give it the authority to approve individual transactions (see below). However, experience in many countries suggests that in a number of industries where severe problems of market power exist, governments have concluded that the ex-post competition policy enforcement is not sufficient to protect the public interest. This is especially true in sectors such as electricity and telecommunications, where incumbent operators have monopoly ownership over an essential facility in the form of a network, which cannot be duplicated by new entrants in a reasonable time frame relevant for the development of competition, and to which new entrants into the industry require access. In such circumstances, most governments also establish a set of ex-ante regulations that require incumbent operators, among other things, to provide access in a non-discriminatory manner to potential entrants that compete with incumbents in downstream or retail markets.

In the absence of such a regulatory framework, the transfer of ownership of network assets to private interests is likely to create serious market power problems and has in principle ambiguous, and most likely negative, welfare consequences.⁷ In fact, in such circumstances privatization should be seen as part of the regulatory framework and it needs to be undertaken in a manner which is consistent with the overall objectives of sectoral policy, which often entails the development of competition in the industry.

⁶ See, for example, the peer review undertaken by the OECD (2005)

⁷ Note that in this case the tradeoff would consist of weighing inefficiencies associated with public ownership and management (such as soft budget constraints, patronage and clientelism, and the like) against inefficiencies of monopoly power. Ultimately, the quality of public administration would be a crucial factor in determining the overall result.

Universal Service

The second general issue that needs to be addressed during privatization has to do with special arrangements that may need to be established to achieve possible distributional and social objectives. Services such as electricity, telecommunications, water and transportation are subject to universal service requirements in most countries, that is, they are treated as services that all citizens should have access to and should be able to consume at reasonable prices irrespective of costs.⁸ This may have two dimensions: Providing these services may be too costly in some regions, for example, if this entails significant fixed costs and population in those regions is sparse. Second, the incomes of some households may be too low to purchase these services at regular tariffs, that is, even when costs are not too different from national averages. Such universal service considerations run counter to the logic of private enterprise and market competition and therefore require special regulatory arrangements. Hence an important issue is to what extent the privatization procedure takes account of such considerations.

The Role of the Turkish Competition Authority in Privatizations

The Competition Board decided in 1998 that privatizations by public agencies are to be treated as merger and acquisition transactions and therefore need to be reviewed under merger provision (Article 7) of the Competition Law.⁹ The review of the Competition Authority in privatizations appears in two instances. First, if the entity being privatized (1) has a market share over 20 percent, (2) has a turnover exceeding TRL 20 trillion (about €9.5 million) (3)

⁸ The term “universal service” is more prevalent in the telecommunications industry. In the European Union, the term “Public Service Obligations” is used in the electricity industry.

⁹ See Communiqué 1998/4 and 1998/5 issued by the Competition Board available at the Competition Authority website www.rekabet.gov.tr

possesses a legal monopoly, or (4) enjoys statutory or de facto privileges not accorded to private firms in the relevant market, then an advance notification needs to be provided to the Board before the tender is announced to the public, so that the Board can provide its views on the proper method of structuring sale of the privatization assets. Second, to become legally effective, the privatization transaction requires a Board approval under the following conditions: (1) where advance notification of the transaction was required, as explained above, or, (2) even if advance notification was not required, where the acquiring firm has a pre-transaction market share above 25 percent or turnover exceeding TRL 25 trillion (about €12 million). Hence in the first stage, the Competition Board can intervene by stating an opinion on the transaction, while at the second stage it effectively can make binding determinations which effectively puts it in the position of a veto authority.

The review by the Competition Board in principle provides an important safeguard against privatizations that may enhance or create market power in the relevant markets. Note, however, that the boundaries of the Board's review are drawn by Article 7. In other words, this is strictly a review that attempts to establish whether the transaction creates a dominant position or enhances an already existing dominant position. Hence, this review in principle cannot compensate for inadequate or incompetent policy design (such as ex-ante sector specific regulation, measures that would be necessary to address other market imperfections or distributional concerns). Moreover, a review under article 7 of the Competition law is a regular merger review: this means that, strictly speaking, the transfer of ownership of an existing public monopoly to private interests, a transaction that does not create a dominant position (as one already exists) or enhance an existing dominant position (given that competition law is ownership-blind) should survive under such a review. In other words, strictly speaking, competition law does not provide an efficient instrument against

transforming public monopolies into private monopolies. From an international perspective, the Turkish case is quite unique in that the Competition Authority has created such a role for itself and that the rest of the administration has accepted it. As will be seen below, in a number of instances this has prevented serious flaws in privatization policy as well as specific privatization transactions.

In non-infrastructure industries, even though there are a number of decisions that has affected privatization policies, overall it can be said that the Board has taken a non-restrictive attitude towards privatization transactions (as will be discussed below, this has not been the case in infrastructure industries). Some of the influential decisions are as follows:

- In 2000, the purchase of IGSAS, a state firm that manufactured nitrogenous and composite fertilizers, by Toros Gübre, a private fertilizer company was not approved because transaction was deemed likely to create a dominant position.
- In 2004 the Competition Board approved the sale of Tüpraş (a refinery) to a German subsidiary of a Tatarstan-based company, but noted that any new refining capacity investment by the firm would be assessed for entry deterrence effects on potential entrants into the refining market.¹⁰
- In 2005, the Competition Board denied approval to three privatization transactions involving the purchase of cement plants sold by the Turkish Deposit Insurance Fund. In two of the cases the purchase was denied because it would create dominance, in the third case it was argued that the purchase would have created joint dominance. Failure

¹⁰ This particular sale was later cancelled by an administrative court and, upon appeal, the cancellation was upheld by the Council of State (the high administrative appeals court). The cancellation decision was based on several justifications, including the following: a) the buyer did not provide all information requested by the tender specifications; b) there were only two potential buyers, hence there was insufficient competition, and c) the privatization method was negotiations rather than an auction, but the choice was not well justified.

to approve meant that instead of the top winners of the tenders, those participants that came in second or third would purchase the plants.

- In 2005 the granting of the transfer of operating rights (TOR) of the Iskenderun Port to the PSA-Akfen group was made conditional on the group not acquiring the TOR of the adjacent Mersin Port. The idea behind this condition was to ensure some degree of competition between these two ports by preventing control by a single operator.
- In 2007 regarding the TOR of the Izmir port, the Board decided that the transfer of the operating rights to one of the contending groups (Alsancak Ortak Girişim Grubu) would likely result in the restriction of competition because one of the partners of the group was already a dominant player in the cargo handling business.

The Competition Board's interventions in the infrastructure industries will be examined in more detail below.

PRIVATIZATION IN INFRASTRUCTURE INDUSTRIES

Telecommunications

Fixed line telecommunications is a prime example of a network industry. Until 20-25 years ago, the industry was organized as a vertically integrated monopoly, under public ownership in most countries, or as a regulated private company in a few cases, most notably the US.

Technological developments and the reduction in the prices of key electronic components made it possible to introduce competition into key segments of the industry. While the local copper network is still considered as an essential facility, the emergence of alternative access technologies is starting to create opportunities for competition even there as well. In any case,

there is a global trend towards enhancing competition in the telecommunications industry. There is wide agreement that this, in turn, requires a set of ex-ante rules that constrain the market power of incumbent operators and that allows new entrants to have various forms of access to the existing network. Privatization of the incumbent operator makes the existence and effective enforcement of such a regulatory framework all the more indispensable.

Privatization of Türk Telekom, the incumbent operator in Turkey, was initially launched with almost no regard for such a regulatory framework. Decree Law No. 509 (1993) intended to allow the government to transfer the rights to operate the company's assets and sell up to 49 percent of its shares. This decree-law was cancelled by the Constitutional Court because the authorizing law had been cancelled.¹¹ Then Law No. 4107 was enacted in 1995 that enabled the privatization of up to 49 percent of Turk Telekom; critical articles of this law were also cancelled by the Constitutional Court, basically because it gave too much discretion to the administration (in this case the Privatization High Council) in determining the valuation and sale conditions of Turk Telekom. These challenges forced the governments to develop a less ad-hoc and more structured approach to privatization. A new phase was launched with Law 4161 (1996), which established and a Value Assessment Committee which was also charged with developing sector policy. This law was also taken to the Constitutional Court for cancellation, but it survived the constitutional judicial review. This was followed in 2000 by the enactment of Law No. 4502 which envisaged the termination of Turk Telekom's monopoly rights by 2003 and which established the Telecommunications Authority in charge of developing sector-specific regulations.

¹¹ The Authorizing Law No 3911 gave wide powers to the government to issue decree-law in diverse fields including social security and privatization. This law was cancelled by the Constitutional Court because, among other things, it amounted to transfer of lawmaking authority from the parliament to the executive.

The main policy objective in the telecommunications industry is or should be the development of a competitive market that may encourage lower prices, new products and services, technological developments and innovation. In principle the privatization of the incumbent operator may serve as an important instrument to reach these overall objectives. It may be expected that, provided that competition develops, private ownership may render the incumbent operator more flexible, more responsive to changing market conditions and better able to respond to the competitive challenges of new entrants. In the case of Turkey, privatization was also seen as an important step towards the development of competition because many in the industry thought it might reduce the influence of Türk Telekom on the Ministry of Transport and level the playing field. In effect, it is generally agreed that liberalization and the development of competition was derailed because of the prospective privatization of Turk Telekom. The government was focused on the revenues that were to be generated through privatization, and therefore delayed the steps taken towards liberalization, in the hope that existence of monopoly rents would fetch higher privatization prices. In particular, there were significant delays in issuing new licenses, signing interconnection agreements and developing the necessary infrastructure (such as cost accounting) for effective regulation. In retrospect, it was as if at the political level the development of a regulatory framework was seen as an instrument to make privatization legally feasible rather than vice versa. Put differently, at the political level privatization was the main objective, not the development of competitive markets.¹²

One should also take note of the role of competition policy in the privatization of the incumbent operator. In its review of the privatization of Turk Telekom, the Board concluded

¹² This is not to say that the regulatory framework that eventually emerged was a sham. On the contrary, with almost no help from the Ministry, the Telecommunications Authority put out a series of secondary legislation that made the rules of the game in Turkey converge (albeit slowly and incompletely) towards those in the European Union.

that the sale of Turk Telekom should be conditioned upon a requirement that the purchaser divest the cable television operation to a different legal entity within one year after purchase, and that the Internet access operation be established as a separate (but wholly owned) entity within the divested company within six months after purchase. The Board further recommended that the dominant private sector GSM service provider not be allowed to participate in the tender. Thus the cable TV assets were separated from Turk Telekom and were placed under the ownership of the state-owned satellite company. The whole point of the Competition Board's opinion was to ensure that the cable TV assets would be privatized separately and thereby the incumbent would face competition through the cable network. However, this privatization has not occurred yet.

Electricity

Privatization is a crucial component of the reform and restructuring program that is being conducted in the electricity industry. The legal basis of the program is Law No. 4628 (Electricity Market Law, later changed to Energy Market Law or EML) that was enacted in 2001. The law envisaged the formation of competitive electricity markets and established the Electricity Market Regulatory Authority (EMRA) to oversee the development of competition, and to design and enforce necessary regulations for access as well as the tariffs of the non-competitive segments. Before examining the role of privatization in the restructuring program, it will be informative to review briefly earlier attempts at attracting private sector investments into the industry.

The government's earlier effort for privatization in electricity entailed attracting private capital through build-operate-transfer (BOT), build operate (BO) and transfer of operating

rights (TOR) contracts.¹³ In 1991 the Council of Ministers authorized some companies to engage in generation, transmission and distribution of electricity in their respective regions. These were exclusive arrangements with no consideration of competitive markets. Moreover, the authorizations themselves were done without any competitive tendering procedure (hence there was no competition in the market or for the market). In 1996 these authorizations were cancelled by the Council of Ministers. The companies appealed at the Council of State (*Danıştay*, the high appeals court for administrative decisions) and won. With the move towards a competitive model in 2001, this situation created a legal confusion that continues to this day.¹⁴ In 1996 the government launched a new round of privatizations of distribution companies under the TOR model. Bids were collected for 25 distribution regions. Bids for five regions were found insufficient, and five regions faced various forms of legal problems. The agreements of an additional four were annulled by the Council of state and ultimately 11 signed concession agreements which were approved by the Council of State. However, these agreements were not implemented. EML envisaged that these agreements would be amended so that they would be suited to the market model adopted. The supplementary articles of the law putting time limits for these amendments were cancelled by the constitutional court. Following the enactment of law 4628, a Strategy Document (discussed in more detail below) issued by the High Planning Council in 2004 redesigned the distribution regions and created 21 distribution regions, 20 of which were to be privatized.¹⁵ In short, the legal status of these TOR contracts are extremely vague.¹⁶

¹³ See Atiyas and Dutz (2005) for a discussion of these contracts.

¹⁴ One of these companies, AYDEM, was recently reported to renew its agreement with the Ministry and obtain a TOR for distribution. In effect, the company has relinquished its exclusivity rights under the old agreements and agreed to be subject to price and other regulations of EMRA as well as a competitive regime in retail supply. See the daily *Referans*, March 22, 2008.

¹⁵ The remaining one is Kayseri. This is really a special case and has been under a concession agreement on and off since the 1920s.

¹⁶ For discussions of the TOR experience in Turkey, see Ulusoy (2005), OECD (2002) and Competition Authority (n.d.)

The important aspect of these TORs was that they gave complete exclusivity to the distribution companies. The bids during the tender were on the distribution tariffs, with the lowest bid winning (OECD, 2002, p. 17). Then these bids were to be used to calculate tariffs which would be then determined for the duration of the contract. There was also a transfer fee, fixed in advance that the winning company would pay the government. Hence, the TOR contracts were designed without any room for competition in the market and with no mechanism that would allow consumers to benefit from any future efficiency gains. This was noted by the Competition Board in its opinion dated 1998 (decision no. 98-87/693-138): The Board stated that exclusivity clauses should be removed, the distribution business separated from retail supply and that instead of fixing tariffs for the duration of the contracts (which was going to be 30 years), that the companies should be free to set tariffs within minimum and maximum prices set by a regulatory authority or the relevant Ministry (in this case the Ministry of Energy and Natural Resources), and that the concession agreement should entail a requirement of non-discrimination (Karakelle, 2000, Competition Authority, n.d.). The Ministry responded by stating that under the prevailing legal framework it was not possible to do these.

There is now general agreement that development of competition in the electricity industry is extremely difficult, if possible at all, if transmission and distribution activities, which display natural monopoly characteristics, are not separated from generation and retail supply which, are potentially competitive.¹⁷ Such separation would ensure that network operators do not have incentives to foreclose markets to downstream competitors in generation or retail

¹⁷ Retail supply typically includes activities such as billing, metering as well as designing tariff packages that would suit different consumer profiles.

supply.¹⁸ There are various degrees of separation, but legal separation (i.e. organizing different activities under different legal entities which may however belong to the same group) seems to be a minimum requirement. The EU has been pushing for ownership separation of transmission activities, which means that companies engaged in transmission cannot have any control relations in companies engaged in other activities in the electricity industry. Under the EML, transmission is to remain under government ownership. The EML also put some restrictions on the amount of electricity that a distribution company could procure from affiliated generation companies. Different accounts needed to be kept for distribution and retail supply activities (accounting separation) but there was no legal separation.

Later, a law passed in 2005 removed all restrictions on distribution companies to engage in retail sales and generation thus allowing vertical integration subject to accounting separation. This was widely interpreted as a move by the government to increase the attractiveness of the distribution assets which were going to be privatized (for example, Sevaioğlu, 2005). This was a serious regression from the EML and was indicating either that the development of a competitive industry was not a main concern or that the Ministry of Energy did not really understand the necessary conditions for such a development to take place.

What was the main concern of the government, then? For one thing, it is likely that the government wanted to get as high revenues as possible, and therefore decorated the distribution assets with monopoly rents, possibly underestimating the welfare costs associated with increased market power. There was possibly a second reason, which was to minimize the risk that the distribution companies could not be privatized. The strategy of the reform

¹⁸ The main problem here is not price discrimination, which can be controlled by tariff regulation, but non-price discrimination, which has turned out to be much more difficult to detect and prevent through regulation.

program was that the distribution companies would be privatized first and the privatization of generation assets would follow after privatization of distribution assets are almost completed. According to the strategy document mentioned above:¹⁹ “Since the distribution companies, holding retail licenses and operating in a liberal market, have to create confidence on investors engaged or to be engaged in generation activities, privatization will start in the distribution sub-sector.” Hence the whole success for the reform program was contingent on the successful privatization of distribution assets.

Common wisdom about liberalization and regulation would be perplexed by this strategy: One would have expected that if competition is at all an important objective, then the restructuring program should have opted for the horizontal break-up of generation assets and their privatization rather than the privatization of the *monopoly segments*! The stated reason for the choice of the government was that if distribution companies were to remain under government ownership, they would not constitute credible buyers for electricity sold by private generation companies. A related theme here was that public managers would be very reluctant to sign contracts with private generators because of the public uproar against the BOT and BO projects of the late 1990s.

It was up to the Competition Authority to upset this arrangement which would have opened the way for the creation of vertically integrated near-monopolies that would have strong incentives to foreclose markets in the future. In its opinion on the privatization of the distribution companies (Competition Authority, n.d.), the Competition Board stated that the Strategy Document seemed to emphasize security of supply and attraction of foreign capital to the neglect of institution of competition and consumers’ interests. The Competition Board

¹⁹ Available at http://www.oib.gov.tr/program/2004_program/2004_electricity_strategy_paper.htm. Downloaded 20 September 2008.

also stated that the first best approach would be to have ownership separation between distribution activities on the one hand and generation and retail supply on the other. Short of that, the Board stated that legal separation by the end of a transition period (effectively 2011) would be a condition for the approval of privatizations. The condition of legal separation was explicitly stated in the tender specifications.

In any case, the privatization of the distribution companies has been seriously delayed. The strategy document has envisaged that by 2006 most of the 22 regional companies would have been privatized. As of October 2008, tenders for only four of the 20 distribution companies have taken place.

Ports²⁰

Ports are characterized by large and long lasting sunk costs, strong economies of density and economies of scale. At the same time, ports provide a multitude of services with different characteristics. It is generally believed that these differences allow for unbundling between activities and introduction of competition in some segments.

Privatization of ports in Turkey has taken the form of TORs. Some smaller size ports under the control of Turkish Maritime Administration (Türkiye Denizcilik İşletmeleri) were privatized between 1998 and 2003. Then in 2004 the Privatization High Council has decided to include in the privatization portfolio six ports under the control of the Turkish State Railways Administration (TCDD). These are the largest ports in Turkey in terms of capacity, connection to railways and highways, infrastructure facilities and hinterland. In its opinion on

²⁰ Information on the Turkish port industry and its privatization can be found in Günaydın (2006) and Competition Authority (2005a).

the privatizations, for some of the ports the Competition Board (Competition Authority, 2005b) listed several structural measures that would prevent the creation of dominant positions. These measures included making room for within-port competition by transferring operating rights to two groups rather than one.²¹ In the end, the operating rights of each port were sold to a single operator. According to the Competition Board, as expressed in its decisions approving these transactions, instead of taking the structural measures proposed in the Competition Board's opinion, the Privatization Administration (PA) opted for restricting potential abuse of dominant position through clauses in the concession contract that would limit discrimination, excessive pricing or limiting supply, and require the operator to adopt cost accounting measures.²² The contract would be enforced and monitored by the Railways Authority. Apparently the Competition Board found these measures adequate.

This is an example of “regulation by contract”, whereby a regulatory arrangement is established through the means of a contract which specifies the rules and conduct limitations imposed on the operator over the duration of the contract. However, there are a number of problems with this kind of an arrangement. First, it is not clear at all whether the Railways Authority would have the capacity to monitor and enforce the regulatory components of the contract. Regulatory oversight requires resources and specific skills that the Railways Authority does not normally have. In fact, the development of such skills and capacity is one of the main reasons why many countries have opted for the “independent regulatory agency” model to regulate and oversee development of competition in infrastructure industries.

Second, the arrangement is completely non-transparent. The concession contract itself is not

²¹ The staff recommendation to the Board had gone a step further and proposed unbundling of piloting and towing services from the rest of port services and privatizing these services in a separate tender (Competition Authority, 2005a)

²² See, for example, Board Decision No. 05-58/855-231 on the Mersin Port and No. 07-47/507-182 on the Izmir Port.

a public document. How prices are going to be regulated, for example, has not been disclosed to the public and therefore is not transparent. Irrespective of whether enforced by an independent agency or a division in a ministry, the advantage of having an open regulatory framework governed by primary and secondary legislation is that it provides some degree of accountability and transparency to the process; transparency, in turn, is expected to enhance the quality of regulations and their enforcement. The legislation on ports is extremely old, and the recent privatizations were carried out without a sector specific legal framework that would clarify the responsibilities of the different parties and how disputes may be resolved in case they arise.

In short, it is not clear whether the government has a port policy at all. What seems to be happening is that instead of designing a port policy, and a regulatory framework that would guide the implementation of that policy, the government has seen privatization as the single panacea to the problems of the port industry.

Universal service

As discussed above, liberalization and privatization have made universal service obligations important in both telecommunications and electricity industries, since the functioning of the market mechanism, even when a reasonable degree of competition is attained, does not ensure that all citizens will have access to basic telephone or electricity services at reasonable tariffs.

In Turkey, in the case of the telecommunications industry, this issue has been addressed through the enactment of a Universal Service Law in 2005. Until the enactment of the law, Türk Telekom was responsible for implementing universal service obligations. According to the law, universal service includes public telephony basic internet and directory services. The

basic logic of the law, which is consistent with the approach in the European Union, is that the provision of universal services will be organized in a competitive fashion, and operators which provide universal services will be compensated on the basis of the net incremental cost of the services provided. However, the law has not been applied yet, and effectively Türk Telekom is the monopoly provider of universal services.

Affordability has been an even more important problem in the case of restructuring in the electricity industry. The problem is aggravated by interregional differences in transmission and distribution losses and theft of electricity. In some regions losses surpass 50 percent of consumption. This means that current tariffs entail significant cross-subsidies and that any tariff that would reflect underlying costs would be prohibitively high in the poorest regions of Turkey. Moreover, with rising energy costs cost-reflective tariffs are likely to generate significant energy poverty among low income households in all regions of Turkey (Bağdadioğlu et. al. 2007). The EML had a specific provision for possible support for such households directly from the budget. However, this clause was later cancelled and the government instead chose to continue with cross-subsidies. The government also refused to raise tariffs in the face of rapidly increasing costs until recently, presumably in part due to concerns about distributional consequences. However, this turned out to be fundamentally inconsistent with the basic market design and with the basic policy objective of the restructuring program, which was to attract new private investment into the industry. In fact, unable to compete with subsidized retail prices of the public distribution companies, some private generators closed shop. While the launching of a short term balancing market in August 2006 has provided a temporary solution to this problem, lack of investment in the interim period has created capacity constraints, driving up wholesale prices, and creating significant losses in the distribution company. A more economically meaningful approach

would have been to design an explicit and consistent universal service policy, funded directly from the budget and rely less heavily on distorting retail prices.

A CONCLUDING ASSESSMENT

It has often been argued that governments in the 1980s and 1990s did not seriously pursue privatization because they did not want to lose control over assets that they could use for political patronage and clientelism. The analysis presented in this chapter suggests that this was not always true. In fact, quite a number of governments did want to pursue privatization but in a non-transparent and non-accountable way. These efforts simply did not meet the legal standards set by the Constitutional Court. Note that from a political-economics point of view, losing control over assets is not without benefits: revenues generated through privatization can be used for patronage and clientelism-related expenditures as well.²³

A few factors seem to have contributed to the rapid increase in privatization in the 2000s. The first factor has to do with the legal framework. By the end of the 1990s a more or less coherent legal framework for privatization was established. Moreover, for the telecommunications and electricity industries there was by the year 2001 a legal framework for the regulation of incumbent operators with monopoly power to ensure non-discriminatory access regimes. The establishment of regulatory authorities with substantial discretion on a wide range of issues including tariffs, access and licensing also must have made privatization

²³ In fact, the act of privatization itself may be and instrument of rent seeking and rent allocation (Schamis, 2002). See Ercan and Onis (2001: 120) and Karakas (2001: 110) for Turkish examples of such cases of privatizations in the 1990s. In the 2000s, two incidents drew wide public commentary (among others): The first one was the sale of a media company to the Çalık Group, owned by the Prime Minister's son in law following a tender where the group faced no competitors. It later turned out that the group was to finance the purchase through credits obtained from state owned banks. The second incident was related to Doğan Group's (a media concern also active in energy) application for a license to build a refinery in Ceyhan, a southern region of Turkey. The owner of the Doğan Group claimed that the Prime Minister told him that he could not establish the refinery in Ceyhan because the Prime Minister promised to allocate the area to the Çalık Group.

somewhat easier by addressing concerns about possible adverse consequences on social welfare.

One should note that this did not mean that individual privatization transactions did not meet legal challenges. In fact, many transactions were cancelled by administrative courts or the Council of State. Even though a thorough assessment of these cases is very difficult since a lot of the information is not in the public domain, a review undertaken by Atiyas and Oder (2008) of some of the Council of State decisions suggests that some of these cancellations had legal/technical reasons, some seem to have occurred because of the way the cases were handled by the privatization agency, some got cancelled because the Council of State was unhappy and overcautious about (the lack of) investment requirements imposed by the administration. In some cases (Petkim is a striking example, see Atiyas and Oder 2008: 144-45), different divisions of the Council of State reached radically different conclusions. However, it is also very clear that there was significant learning involved. Some cases which got cancelled by the Council in the first round nevertheless survived the second round because the PA could address the concerns raised by the Court.

The availability of a legal framework removes barriers to privatization, that is, of course, if the government is willing to privatize. Clearly the AKP governments that came to power in 2002, soon after the 2001 crisis, showed a strong preference for privatization. What could explain this preference? The extremely high level of public debt that the government inherited from the crisis, and the consequent necessary fiscal adjustment, must have provided strong incentives for privatization. As explained in detail in Ersel (2008), interest payments on debt severely curtailed the volume of current expenditures. The government must have been aware that reducing the level of public debt by privatization revenues would eventually

create flexibility in current expenditures (which was indeed created somewhat after 2005, see Ersel (2008)) without jeopardizing fiscal policy significantly. In fact, obtaining revenues was not the only fiscal objective related to privatizations. The other important objective was mobilizing the private sector to undertake necessary investments in infrastructure, which would also help reduce the burden of the fiscal adjustment and create flexibility in current expenditures.

The fact that post-crisis governments were single party governments must have helped as well. As discussed in Ercan and Öniş (2001), coalition governments are susceptible to fragmentation in the policy making process. In that sense single-party majority governments are expected to be able to produce more coherent public policy although the experience with electricity liberalization in Turkey shows that single party governments are also not immune from substantial incoherence in public policy.

Opposition to privatization policies by trade unions continued in the 2000s, if not as strongly as in the earlier period. One of the most frequent tools used by trade unions was to challenge administrative decisions (for example, by the Privatization Authority) pertaining to privatization by taking them to administrative courts or the Council of State and requesting their cancellation. As discussed above, this strategy lost effectiveness over time, possibly because the Privatization Authority improved its competence in addressing concerns raised during these legal challenges.

From a more normative perspective, one may conclude first of all that in Turkey fiscal considerations of the sort described above have always dominated considerations regarding improvements in long term productivity. In more than one case, a drive to increase the

attractiveness of the assets to be privatized and therefore to maximize sale revenues have led governments to delay or neglect measures that were necessary to encourage the development of competition. Even in the case of electricity, where privatization was apparently treated as part of a larger package of restructuring and liberalization, the whole process was dominated by privatization.²⁴ At a more general level, it seems that the government has seen privatization as a general panacea, and as an excuse to free itself from the task of developing good public policy.

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²⁴ One may contrast this with the case of Norway, for example, which is part of a regional electricity market that is widely seen as one of the most successful cases of restructuring: Many energy companies in Norway were state owned (and some continue to be state owned).

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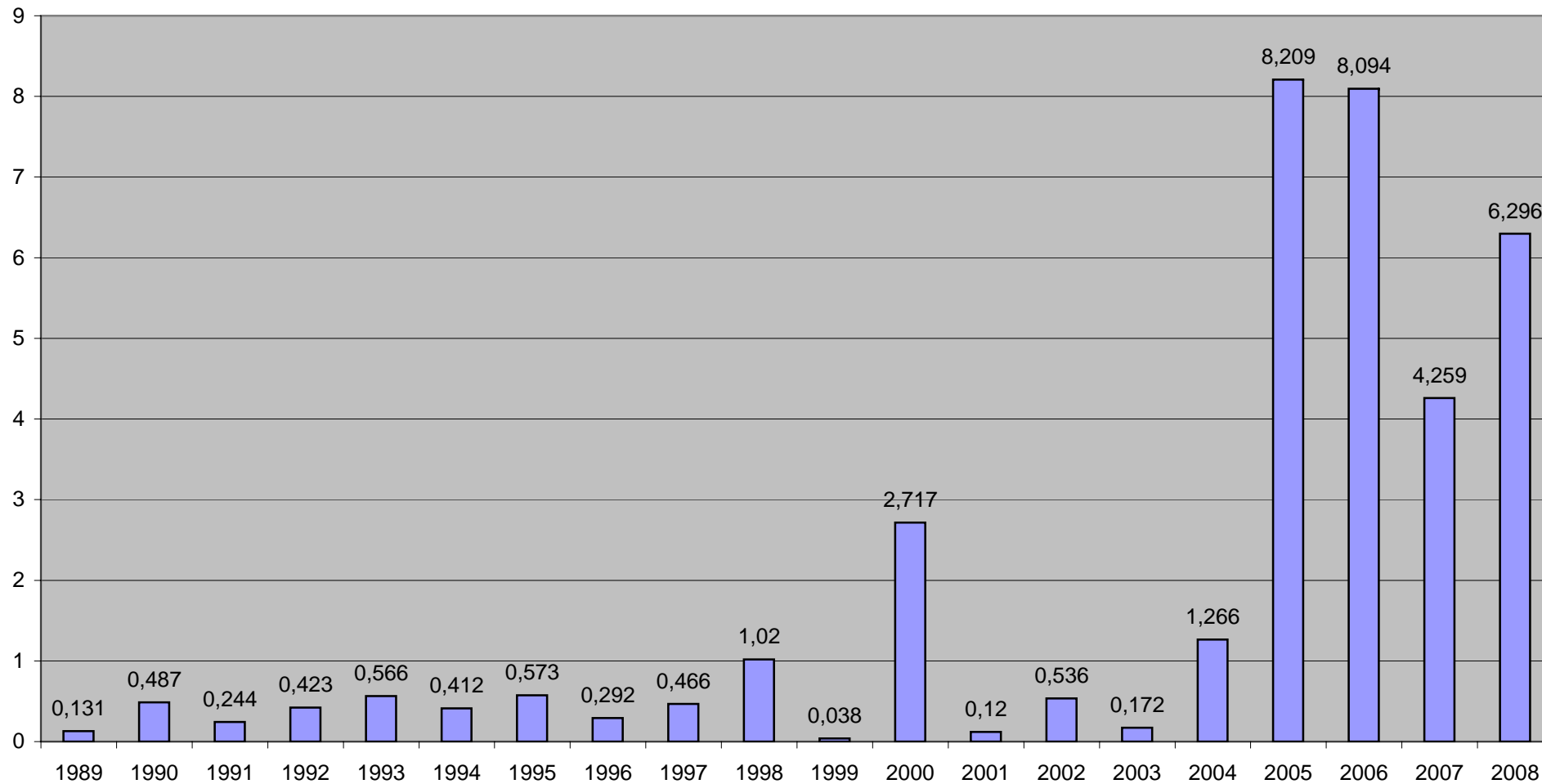
Table 1: Major Privatization Transactions

	Percent share held before privatization	Percent share sold	Method	Date of sale	Revenue raised (\$ mil.)
<u>Completed Transactions</u>					
Eti Alüminyum (Aluminum)	100,00	100,00	Block sale	29/07/2005	305
Başak Sigorta (insurance)	56,67	56,67	Block sale	16/05/2006	204
Asil Çelik (steel)	96,60	96,60	Block sale	29/08/2000	131
İş Bank	12,30	12,29	Public offering	4-6/05/1998	633
Etibank	100,00	100,00	Block sale	02/03/1998	156
Türk Telekom (telecommunications)	100,00	55,00	Block sale	14/11/2005	6.550
	45,00	15,00	public offering	7-8-9/05/2008	1.928
Erdemir (iron and steel)	50,68	2,93	Public offering	9-10/04/1990	53
	46,12	46,12	Block sale	27/02/2006	2.770
Tüpraş (refinery)	100,00	1,66	Public offering	27-29/05/1991	6
	96,42	30,65	Public offering	5-7/04/2000	1.105
	51,00	51,00	Block sale	26/01/2006	4.140
Petkim (petrochemicals)	99,97	8,08	Public offering	18-29/06/1990	151
	88,86	34,50	Public offering	13-15/04/2005	274
	61,32	51,00	Block sale	30/05/2008	2.040
Petrol Ofisi (petroleum distribution)	100,00	4,02	Public offering	27-29/05/1991	14
	93,30	51,00	Block sale	21/07/2000	1.260
	42,30	16,50	Public offering	27.02-15.03/2002	168
Turkish Airlines	100,00	1,55	Public offering	29.11-7.12/1990	5
	98,17	23,00	Public offering	1-3/12/2004	191
	75,18	28,75	Public offering	16-18/05/2006	208
T. HALK BANK	99,96	24,98	Public offering	2-4/05/2007	1.839
TCDD - Mersin Port			TOR	11/05/2007	755
Real estate in Istanbul			Block sale	30/05/2007	800
Motor vehicles inspection station 1.region			Concession	15/08/2007	300
Motor vehicles inspection station 2.region			Concession	15/08/2007	313
Hilton Hotel			Block sale	15/11/2005	256
Tarabya Hotel			Block sale	30/06/2006	145
Efes Hotel			Block sale	07/03/2006	122
TEKEL (Tobacco)			Block sale	24/06/2008	1.720
ADÜAŞ (electricity generation)			Block Sale	05/03/2008	510
<u>Transactions in the signature stage</u>					
TCDD Izmir Port			TOR	03/07/2007	1.275
TCDD Derince Port			TOR	22/11/2007	195
TCDD Bandırma Port			TOR	16/05/2008	176
TCDD Samsun Port			TOR	16/05/2008	125
Başkent (electricity distribution)			TOR	01/07/2008	1.225
Sakarya (electricity distribution)			TOR	01/07/2008	600

Source: Compiled from data on PA website (www.oib.gov.tr); sales over \$100 m. as of September 2008

Note: TOR - Transfer of Operating Rights

Figure 1: Privatization Revenues (\$ bil.)



Source: Privatization Administration website (www.oib.gov.tr)

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9 Privatization in Turkey

What has been achieved?

Çağla Ökten

The best of all monopoly profits is a quiet life.

(Sir John Hicks)

Introduction

In the last two decades, many countries have launched extensive privatization programs. There is now a growing body of literature on the effects of privatization on efficiency. In this chapter, we first review the theoretical and empirical literature on privatization. We then focus on privatization efforts in Turkey and analyze the Turkish experience within the context of the literature.

Privatization efforts in Turkey, fueled by the forces of globalization, started in 1985. These efforts should be considered as part of a larger plan which conceived that regulations, policies, and incentives should be readjusted to liberalize the Turkish economic environment for private and foreign direct investment (Öniş, 1991; Karataş, 2001). The primary objectives of the privatization program were to (1) minimize state involvement in economic activities; (2) promote competition, improve efficiency and increase the productivity of public enterprises; (3) relieve the state from the burdens of inefficient state industries; (4) facilitate a wider distribution of share-ownership and develop a viable capital market; and (5) create revenue for the government.

Although the privatization process in Turkey had started earlier than in most developing countries, its progress – measured in terms of the size of divestiture – had been slower when compared with the principal Latin American and Eastern European cases (Ercan and Öniş, 2001). From its start in 1985 up to 2005, the total proceeds from privatization efforts have amounted to \$9.4 billion. More than half of this has been realized in the 2000–2005 period after the 1999 IMF Stand By agreement that placed a particular emphasis on privatization.

In the next section, we first review economic theory of privatization and identify arguments for and against public ownership. The economic theory of privatization is a subset of the vast body of literature on the economics of ownership and the role for government ownership of productive resources. There are two main branches in this literature: The Social View (Shapiro and Willig, 1990) and the Agency View (Vickers and Yarrow, 1988; Shleifer and Vishny, 1994).

We then turn our attention to empirical studies that examine the effects of privatization and identify common findings as well as conflicting results in the literature.

In the section on Privatization process in Turkey, we describe the privatization environment and process in Turkey. As a case study, we focus on the privatization process of Türk Telekom to show the specific challenges that privatization efforts had to face. In the section on Objectives of Turkish privatization: what has been achieved?, we assess the achievements of the Turkish privatization experiment in terms of reducing state's involvement in the economy, increasing efficiency, and generating revenue. The final section concludes.

Literature review

Theoretical literature on privatization

The economic theory of privatization is a subset of the vast body of literature examining the economics of ownership and the role of government ownership of productive resources. There are two main branches in this literature: the Social View and the Agency View.

According to the Social View (Shapiro and Willig, 1990), state-owned enterprises (SOEs) are capable of curing market failures by implementing pricing policies that take into account of social marginal costs and benefits of production. A privately owned firm is expected to maximize profits whereas a state owned firm is expected to maximize social welfare. For example, in a natural monopoly market structure, efficiency calls for a single firm to exist. A profit maximizing monopoly will, however, charge too high a price and produce too low a quantity. This potential inefficiency can be solved by state ownership.

The Agency View of firm ownership presents a strong critique of this theory. There are two complementary strands of the literature which differ as to whether the agency conflict is with the manager or the politician. Vickers and Yarrow (1988) argue that managers of SOEs may lack high-powered incentives or proper monitoring. Shleifer and Vishny (1994) stress that political interference in the firm results in excessive employment, poor choices of product and location, lack of investments and ill-defined incentives for managers.

The Social View unequivocally predicts that efficient technology will be chosen by the state-owned firms. Models of the Agency View, on the other hand; while predicting that inefficient technologies will be chosen by politicians/managers, have different predictions for the direction of the distortion in the production process. They either predict that state-owned firms will have low investment levels (Shleifer and Vishny, 1994) or that they will use excess capital as well as excess labor (Vickers and Yarrow, 1988). The over-capitalization argument stems from bureaucratic inefficiency models. The founder of this line of literature, Niskanen (1975), proposed that bureaucrats are inclined to maximize their total budget rather than the utility of their sponsors. Vickers and Yarrow (1988) argue that the bureaucrats will subject the state-owned firm to over-investment and over-capitalization to justify high salaries and perks.

On allocative efficiency, the Social View predicts that prices are likely to rise as a result of privatization. The Agency View, on the other hand; predicts that if a reasonable degree of competition ensues then allocative efficiency may actually increase as firms increase their productivity after privatization.

Empirical literature on privatization

Privatization and productive efficiency Firm performance has been the focus of the empirical literature on privatization. Studies cited in a survey of empirical studies of privatization almost unanimously report increases in firm performance associated with privatization (Megginson and Netter, 2001).¹ Most of these studies compare post-privatization performance changes with either a comparison group of non-privatized firms or compare three year mean/median performance of privatized firms to their own mean/median performance during their last three years as state owned firms.

Critics of these findings are quick to point out that most of the gains researchers have documented after privatization are due to selection bias. The argument is that better firms are privatized first and their comparison to more poorly performing firms which happen to remain public gives a spurious relationship between privatization and firm performance. Cross-sectional studies may not satisfactorily control for firm-specific effects and therefore address the selection problem for privatization. While comparing before and after three year averages of performance measures might be more promising, even that method may not entirely solve the selection problem. One could argue that, those firms would have improved at any rate even if they were not privatized (Omran, 2004). When Omran compares before and after privatization averages of performance measures of privatized firms from Egypt, he finds a significant increase in performance. When he carries out the same exercise for firms that remain state-owned, he finds that they also improve after the privatization period though they themselves are not privatized. Either the improvement of privatized firms had spillover effects on state-owned firms or privatization has nothing to do with the changes observed. The author suggests that other economic reforms that enhanced the competitive environment in which his sample of privatized and state-owned firms operate might have been responsible for his findings.

Recent studies improve on methodology by using panel data methods. Using firm fixed effects, they control for unobserved firm heterogeneity a potential source for selection bias (Ehrlich *et al.*, 1994; Frydman *et al.*, 1999; Villalonga, 2000; Wallsten, 2001; Earle and Telegdy, 2002; Ökten and Arin, 2005).

The results of these studies on privatization and firm performance are mixed. Ehrlich *et al.* use a sample of 23 comparable international airlines of different ownership categories over the period 1973–1983. Their results suggest that private ownership leads to higher rates of productivity growth and declining costs in the long-run, and that these differences are not affected by the regulatory environment. Their estimates suggest that the short-run effects of changes from state to private ownership on productivity and costs are ambiguous.

Villalonga examines 24 Spanish firms from different industries and finds that privatization does not increase firm efficiency – defined as rate of return on assets. He argues that political factors such as the business cycle during which the firm is privatized and foreign ownership are important determinants of firm efficiency. Wallsten (2001) finds that in the telecommunications sector, privatization by itself does not appear to generate many benefits and is negatively correlated with main line penetration. He points out the importance of regulatory framework ensuing privatization as he finds that privatization combined with the existence of a separate regulator, is correlated with increased connection capacity and labor efficiency as measured by employees per main line.

Earle and Telegdy find that privatization increases labor productivity growth in their heterogeneous sample of Romanian firms. Frydman *et al.* find that privatization to outsider owners has significant effects on revenue performance, but not on cost reduction using data from the Czech Republic, Hungary, and Poland, on 218 state-owned firms of which 128 were privatized during the 1990–1994 period. We should note that testing the effects of privatization on firm performance is even more difficult in transition economies than in non-transition economies as privatization in these countries occurs at the same time as and is part of, other massive economy-wide changes (Johnson *et al.*, 1994).

Ökten and Arin (2005) find that privatization increases labor productivity of Turkish cement plants in a study which controls for firm fixed effects and time effects with yearly dummies. We will discuss this study in detail in the section on Empirical studies of the cement industry.

Privatization and allocative efficiency Studies that examine the effect of privatization on allocative efficiency are rare (Megginson and Netter, 2001). These studies typically find that prices either increase or do not change after privatization. La Porta and Lopez-De-Silanes (1999) analyze Mexican firms from a variety of industries and find that consumer prices increase after privatization. In their analysis of the water and sewerage industry of England and Wales, Saal and Parker (2001) find that, output prices increase and furthermore, total price performance indices reveal that increases in output prices have outstripped increases in input costs. On the other hand, in a cross-country panel study of the telecommunications sector, Wallsten (2001) finds that prices are not correlated with privatization but are negatively correlated with competition measured by the number of mobile operators not owned by the incumbent. Ökten and Arin (2005) find that prices in the Turkish cement sector decrease following privatization.

It is unrealistic to expect that the effects of privatization on prices will be the same in every industry. Market structure of an industry – market power of firms in the industry – as well as firms' productivity will affect consumer prices. Studies should strive to differentiate the effects of private ownership from the changes in market structure and competitive environment induced by privatization.

Privatization and input choice Empirical studies of privatization do not directly examine the changes in input choice as a result of privatization. Rather, they report changes in employment and capital investment, which may suggest a change in technology. In their survey article, Megginson and Netter (2001) report

that almost all of the 22 studies from non-transition economies that they review find that capital investment spending increases significantly as firms are privatized. Perhaps surprisingly, they report that these studies are far less unanimous regarding the impact of privatization on employment levels in privatized firms.

La Porta and Lopez-De-Silanes (1999), in their study of 233 privatized Mexican firms, find that ratios of investment to sales and investment to fixed assets significantly increase after privatization while employment significantly decreases.

Bhaskar and Khan (1995) find that privatization has a large and significant negative effect on white-collar workers using employment data from Bangladesh, for 62 jute mills of which 31 were privatized.

Privatization and market structure There are only a few studies that have sought to estimate the effects of market structure along with privatization. These studies typically include some type of measure for market concentration as an additional control when they analyze the effects of privatization on firm productivity. In general, they do not analyze how privatization affects market structure or how changes in market structure affect allocative efficiency. Angelucci *et al.* (2001) analyze the effects of competitive pressures – measured by Herfindahl index and share of imports in sales – and ownership changes on productivity in Bulgaria, Poland, and Romania. Anderson *et al.* (2000) analyze the effects of competition and ownership in the productivity of the newly privatized enterprises using data from Mongolia. Kattuman and Domanski (1997) analyze market concentration ensuing mass privatization in Poland and find that concentration increased promptly in several markets. Warzynski (2003) in his study of 300 Ukrainian firms finds that competition does not have a significant effect on firm performance measured by productivity and profitability while privatization has a marginal positive significant effect on profitability and an insignificant effect on productivity. However, he points out that competition and privatization might be complementary measures as he finds that competition increases the performance of privatized firms.

Revenue generation Generating government revenue is a common objective in privatization. Governments use a variety of sales methods to achieve this objective including share issue privatizations (SIPs) and direct sales via auctions. According to the World Bank, over 12,000 companies were privatized during the period 1980–1993 (almost half were divested between 1991 and 1993), and less than 5 percent of these divestitures involved public share offerings. However, SIPs have accounted for the vast majority of the assets and employees moved from the state to the private sector through privatization. Perhaps, that is why a large number of studies focus on pricing in SIPs. Jones *et al.* examine 630 SIPs from 59 countries that raise over \$446 billion during the period 1977–1997 and find that government consistently underprice SIP offers, tilt their share allocation patterns to favor domestic investors, impose control restrictions on privatized firms, and typically use fixed price offers rather than book building or competitive tender offers. The most likely explanation for underpricing is that it ensures a high demand for shares offered.

Few studies analyze the determinants of privatization prices that resulted from direct sales of assets and companies via auctions (Lopez-De-Silanes, 1997; Arin and Ökten, 2003). Lopez-De-Silanes (1997) examines 236 Mexican firms, which were privatized between the years 1983 and 1992. Arin and Ökten (2003) use a data set of 68 privatized firms from Turkey. Both studies find that the number of bidders increases privatization prices by increasing the level of competition in these auctions. However, there are notable differences on how firm characteristics affect privatization prices. While Lopez-De-Silanes finds that low profitability of state-owned prices explain the low price paid, Arin and Ökten find that revenues and market characteristics affect privatization prices, not profits. Arin and Ökten argue that what fundamentally determines the privatization price is the expected future profit of the firm. We will discuss Arin and Ökten study in more detail in the section on Revenue generation and share ownership.

Privatization process in Turkey

Historically, Turkey has a long experience of relying heavily on SOEs. SOEs were established during the 1930s by the government to jump-start the economy which had collapsed with the end of the Ottoman era in 1923. Over the years SOEs grew enormously, leaving the control of a large section of the economy to bureaucrats and politicians. By 1960, share of public sector in total value added in manufacturing was 60 percent. Politicians exploited SOEs to provide jobs to their constituents at the expense of consumers, who were faced with higher prices. Consequently, in the 1980s, SOEs began to be perceived negatively due to poor financial performance, overstaffing, dependence on subsidies, protected markets, and corruption (Ertuna, 1998). Furthermore, public enterprises were able to operate with a "soft budget" constraint which constituted an additional source of relaxation in performance, resulting in greater inefficiency (Öniş, 1991).² After a Military Regime (1980–1983), the first party that came to power was the Motherland Party (ANAP) under the leadership of Prime Minister Turgut Özal. Özal was a strong supporter of Thatcherism which promoted a reduction of the state's role in the economy. Privatization first entered the political agenda with Özal's trade and capital account liberalization program in 1984.

Despite this initial enthusiasm, the privatization process has been slow. Since its start in 1985, total proceeds from privatization efforts amounted to \$9.4 billion by 2004. More than half of this was realized in the 2000–2004 period after the 1999 IMF Stand By agreement that placed a particular emphasis on privatization. Figure 9.1 shows annual total proceeds from privatization during 1985–2004. The observed spike in year 2000 is largely due to the block sale of the 51 percent of POAS (Petroleum Products Distribution) to Dogan Holding-İşBank consortium group for \$1.260 billion³ and public share offerings of the 31 percent of Tupras (Petroleum Refinery) which amounted to \$1.194 billion.

Since 1985, state shares in 244 companies, 22 incomplete plants, 6 real estates, 4 power generation plants, 6 toll motorways, 2 Bosphorus bridges, 29 plants, and 1 service unit have been taken into the privatization portfolio (OIB, 2005). Later, state shares in 23 companies, 4 power generation plants, and 4 real estates have

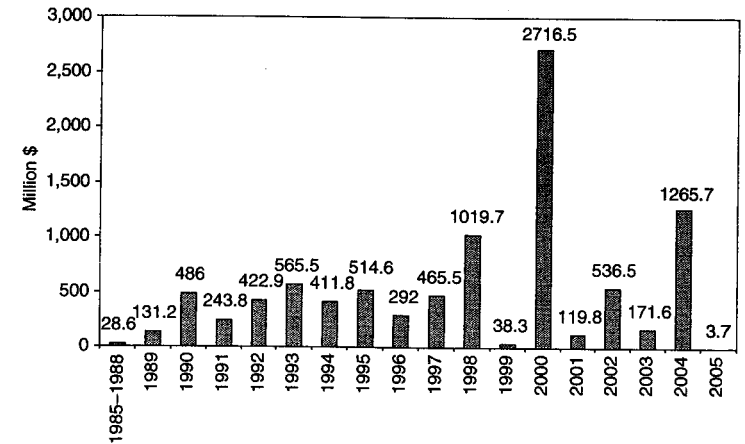


Figure 9.1 Revenues from privatization (million dollars).[†]

Note

[†] As of February 1, 2005 while the manuscript was in press revenues in 2005 amounted to 1,315.1 million dollars.

been taken out of the portfolio for various reasons. Over half of those that remained in the privatization portfolio have been fully privatized. Most of the full privatizations have been sales of assets or sales of minority state shares. Currently, there are 34 companies, 29 plants, 1 real estate, 6 toll motorways, 2 Bosphorus bridges in the portfolio. State shares amount to more than 50 percent in 24 of the 34 companies.

Block sales have been the most prevalent method of privatization. Forty-two percent of the total proceeds have been realized through block sales, 18 percent through public offerings, 16 percent through asset sales, and 12 percent through international offerings, 8 percent through sales in Istanbul Stock Exchange (ISE). Table 9.1 shows the list of the highest grossing (in total proceeds) 47 block sales. We notice that 19 of these are cement plants highlighting the importance of cement industry in the privatization process. Table 9.2 shows domestic public share offering privatizations, Table 9.3 shows international public share offering privatizations and Table 9.4 shows the list of companies that were privatized through a combination of block sales and public offerings.

The privatization reforms have not been fully carried out as intended, due to the lack of a legal framework, conflicting laws, and a wavering political will. Privatization efforts faced strong opposition by entrenched vested interests, notably senior bureaucrats in government departments and SOEs, Workers' Unions who have expressed serious concern about the possibility of mass lay offs, and leftist political parties (Karataş, 2001).

Following many amendments in the laws governing privatization of SOEs and a mind boggling number of decree-laws that were frequently invalidated by the

Table 9.1 Privatizations through block sales

Company	State share (%)	Share sold (%)	Buyer	Date	Sale price (\$)
Etilbank (Bank)	100.00	100.00	Medya-Ipek holding A.Ş.	02.03.98	155,500,000
Asil Çelik (Steel)	96.64	96.64	Yazici-Güriş-Parsan	29.08.00	131,000,000
Lalapaşa Cement	100.00	100.00	Rumeli Çimento A.Ş.	14.06.96	125,890,000
Bursagaz (Gas distribution)	100.00	100.00	Çalık Enerji San. Tic. A.Ş.	19.04.04	120,000,000
Kümaş (Mining)	99.74	99.74	Zeytinoglu Holding A.Ş.	28.09.95	108,100,000
Sümerbank (Bank)	100.00	100.00	İpek Tekstil San. A.Ş.	17.10.95	103,460,000
Denizli Cement	100.00	100.00	Modern Çimento	04.12.92	70,100,000
Anadolubank (Bank)	100.00	100.00	Mehmet Rüştü Başaran	07.05.97	69,500,000
Denizbank (Bank)	100.00	100.00	Zorlu Holding	29.05.97	66,000,000
İpragaz (Gas distribution)	49.33	51.00	Primagaz A.G.	27.01.92	64,066,776
İskenderun Cement	100.00	100.00	Oyak-H. Ömer Sabancı	02.12.92	61,500,000
Deniz Nakliyatı T.A.Ş. (Transportation)	99.99	99.99	Armatörler Den. Ve Nak. A.Ş.	24.03.00	59,000,000
Eti krom A.Ş. (Mining-chrome)	100.00	100.00	Yüdirim Dış Ticaret Paz. A.Ş.	14.09.04	58,050,000
Ladik Cement	100.00	100.00	Rumeli Çimento	21.04.93	57,598,687
Şanlurfa Cement	100.00	100.00	Rumeli Çimento	21.04.93	57,405,988
Gaziantep Cement	99.73	99.73	Rumeli Holding	03.12.92	52,695,898
Adiyaman Cement	100.00	100.00	Teksko Giyim San. A.Ş.	16.08.95	52,500,000
Çayeli Bakır İşl. A.Ş. (Mining-copper)	45.00	45.00	İnmet Madencilik A.Ş.	23.09.04	49,250,000
Ergani Cement	100.00	100.00	Rumeli Çimento San. A.Ş.	03.04.97	46,700,000
Esgaz (Gas distribution)	100.00	100.00	Kolin İnş. Tur. San. Ve Tic. A.Ş.	10.03.04	43,000,000
Eti Güneş A.Ş. (Mining-silver)	100.00	100.00	Kas Mad. İnş. Tur. San. Ve Tic. A.Ş.	13.08.04	41,200,000
Konya Krom Man. A.Ş. (Mining-chrome)	100.00	100.00	Konya Selçuklu San. Tic. A.Ş.	05.06.98	40,700,000
Havaş (Airport services)	100.00	60.00	Yazeks A.Ş.	17.04.95	36,000,000
Petlas (Tyre production)	99.97	99.97	Kombassan Holding A.Ş.	06.05.97	35,750,000
Çorum Cement	100.00	100.00	Yibites Holding	25.12.92	35,000,000
Ankara Cement	99.30	99.30	SCF	08.09.89	33,000,000
Trabzon Cement	100.00	100.00	Rumeli Holding	03.12.92	32,551,000
Aşkale Cement	100.00	100.00	Erçimsan	17.06.93	31,158,000
Yarımcı Porselen (Porcelain)	100.00	100.00	Evyap San. Tic. A.Ş.	09.07.98	30,500,000
Sivas Cement	100.00	100.00	Yibites Holding	25.12.92	29,400,000
Div-Han A.Ş.	100.00	100.00	Erdemir	15.04.04	28,500,000
Kurtalan Cement	100.00	100.00	Canlar Oto İnş. San. Ve Tic. A.Ş.	09.01.98	28,100,000
Elazığ Cement	99.89	99.89	Oyak/Gama A.Ş.	12.06.96	27,850,000
Havaş (Airport services)	40.00	40.00	Turgay Çimer	30.03.98	27,100,000
Pınarhisar Cement	99.90	99.90	SCF	08.09.89	25,000,000
Van Cement	100.00	100.00	Rumeli Çimento A.Ş.	12.06.96	24,500,000
Balıkesir Cement	98.30	98.30	SCF	08.09.89	23,000,000
Kars Cement	100.00	100.00	Çimentaş Grubu	18.06.96	22,250,000
Eti Bakır A.Ş. (Mining-copper)	100.00	100.00	Ce-Ka İnş. Mak. Mad. San. Tic. A.Ş.	12.04.04	21,879,000
Bet Kitahya Şeker (Sugarproduction)	56.00	56.00	Torunlar Gıda San. Tic. A.Ş.	08.10.04	21,438,000
Bartın Cement	99.78	99.78	Rumeli Çimento	06.05.93	20,568,669
Güneş Sigorta (Insurance)	30.00	30.00	Gan International	01.07.91	18,900,000
Filyos Ateş Tuğlasi	100.00	100.00	Zonguldak Yatırım Makinaları A.Ş.	13.05.97	18,150,000
Eti Elektrometalurji	100.00	100.00	Aksu Mad. San. Tic. A.Ş.	25.10.04	15,320,000
Çinkur (Mining)	98.41	98.41	K.M.M. Kayseri Maden Metal A.Ş.	22.05.96	14,000,000
Ansan - Meda	88.33	88.33	Atlantic Ind. Ltd	18.11.88	13,000,000
Borzyük Seramik A.Ş. (Ceramics)	100.00	100.00	Ercan Madencilik A.Ş.	01.10.97	12,000,000

Source: Compiled and rearranged from tables of Privatization Administration.

Notes

This list does not include all the privatizations through block sales. Companies are ranked according to the total proceeds from their privatization.

Table 9.2 Public share offering privatizations

	State share at date of offering (%)	State share offered (%)	Date of offering offered	Total proceeds (\$)	Number of applicants
Erdemir (steel)	48.65	2.93	9-10.04.1990	53,105,711	33,953
Arçelik (appliances)	13.32	5.83	30-4/1.5.1990	19,890,196	12,618
Bolu Cement	34.50	10.38	30-4/1.5.1990	8,268,150	8,157
Çelik Halat (steel)	19.42	13.25	30-4/1.5.1990	7,750,179	6,517
Petkim (petro- chemicals)	99.97	8.08	18-29.6.1990	150,617,183	76,119
Konya Cement	39.87	31.13	24-25.10.1990	17,663,979	6,396
Ünye Cement	49.21	2.86	1-2.11.1990	927,162	281
Mardin Cement	46.23	25.46	22-23.11.1990	9,161,501	1,280
Thy (turkish airlines)	100.00	1.55	29-11.7.12.1990	4,976,165	2,488
Adana Cement	23.86	17.16	18-20.2.1991	25,162,623	3,355
Adana Cement	23.42	17.16	18-20.2.1991	2,795,847	3,355
Migros (grocery chain store)	42.22	36.40	25-26.2.1991	5,609,246	3,951
Ditaş (spare parts)	14.77	2.51	6-7.5.1991	219,411	1,263
Tüpraş (petroleum refinery)	100.00	1.66	27-29.5.1991	6,036,589	15,456
Tofaş Türk (auto)	23.13	0.85	13-14.6.1991	6,119,572	3,147
Tofaş Türk	4.46	0.13	4-7.3.1994	2,824,239	801
T. İş Bankasi (bank)	12.30	4.90	4-6.5.1998	240,702,529	80,978
Tüpraş (petroleum refinery)	96.42	23.88	5-7.4.2000	839,028,679	369,566
Thy (turkish airlines)	98.17	8.05	1-3.12.2004	65,326,696	29,280
Total				1,466,185,657	658,961

Constitutional Court, the first stand alone Privatization Law was ratified by Parliament in November 1994. After a round of revisions, the Privatization Law took its final form in April 1997. A legislation making international arbitration in disputes over contracts involving provision of public services was passed in August 1999. This legislation opened the door for active foreign participation particularly in infrastructure and utility privatizations (Aybar *et al.*, 2001).

Stand By Agreement with the IMF in December 1999 and the ensuing stabilization program to establish macroeconomic stability placed a particular emphasis on privatization which in turn increased the speed of privatization. Currently, there appears to be both external pressure and internal political will by the one

Table 9.3 International public offering privatizations

	State share at date of offering (%)	State share offered (%)	Date of offering	Total proceeds (\$)
Tofaş Türk (Auto)	21.13	16.67	03.03.1994	330,000,000
T. İş Bankasi (Bank)	12.30	7.39	4-6.05.1998	391,949,083
Tüpraş (Petroleum refinery)	96.42	6.77	5-7.04.2000	265,491,985
Poaş (Petroleum distribution)	42.30	3.50	6-15.03.2002	38,891,914
Thy (Airline)	98.17	14.95	1-3.12.2004	125,952,471
Total				1,152,285,453

Source: Compiled and re-arranged from tables of Privatization Administration in Turkey.

party majority government to complete the remaining more controversial privatization projects. We will now review the privatization process of one of these, the privatization of Turk Telekom since this case is illustrative of the challenges that the privatization efforts had to face.

Privatization of Turk Telekom The telecommunications industry was once considered a textbook example for a natural monopoly since the fixed landline structure of this industry resulted in large-scale economies and hence efficiency required one firm to exist. Recent technological advances in this sector, such as the spread of wireless technology and communications via internet have produced alternatives to the fixed landline structure and made a competitive environment more viable.

Even if there is one dominant firm in this market, whether that firm should be state-owned or privately owned but supervised by a regulatory agency is open to debate. The trend in the world has been for the privatization of the telecommunications industry. During 1990-1999, 49 countries have privatized their telecommunications firms either partially or fully (Yılmaz, 2000).

An analysis of the privatization process of Turk Telekom is useful in understanding the privatization environment and process in Turkey. The privatization of Turk Telekom was initiated in 1994, only months after the September 1993 communique establishing the Turk Telekom as a separate entity from PTT and has not been completed as of today. In May 1995, law 4107 authorized the sale of 49 percent of the company and opened the door for telecommunications license agreements. However, since then privatization of telecommunication services has been subject to political and legal squabbling. In February 1996, the Constitutional court overturned critical parts of the law. After several round of cancellations the law 4161 was enacted. In the context of this law, Turk Telekom privatization was linked to sector reform, and company valuation, which would be followed by the sale of the company (Aybar *et al.*, 2001).

In 1998, the Council of Ministers adopted a sales strategy which consisted of a block sale of 20 percent to a strategic partner followed by a 19 percent of initial

Table 9.4 Privatizations through block sales and public offerings

	State share at date of offering (%)	State share offered (%)	Buyer	Date	Total proceeds (\$)	Number of applicants
Afyon Cement						
Block sale	99.60	51.00	SCF	08.09.1989	13,000,000	
Public offering	48.60	39.87	Public offering	21-26.03.1991	8,422,698	12,591
Tofaş Oto Tic. (Auto)						
Block sale	39.00	16.00	Fiat Auto S	22.02.1991	13,203,441	
Public offering	23.00	1.36	Public offering	13-14.06.1991	966,248	3,147
Nigde Cement						
Public offering	99.84	12.72	Public offering	13-14.05.1991	2,647,286	1,125
Block sale	87.12	87.10	Oyak-Sabancı	23.03.1992	22,500,000	
Çukurova Elekt. (Electricity)						
Public offering	18.65	5.45	Public offering	16-17.04.1990	38,829,409	22,184
Block sale	11.50	11.25	Rumeli Elekt.	16.02.1993	81,096,791	
Kepez Elektrik (Electricity)						
Public offering	42.05	8.14	Public offering	16-17.04.1990	9,390,359	8,320
Block sale	25.39	25.39	Rumeli Elekt.	16.02.1993	33,158,988	
Netaş (Telecommunications)						
Block sale	49.00	20.00	NTL	01.03.1993	26,000,000	
Public offering	29.00	7.75	Public offering	3-5.11-12.3.1993	8,723,623	4,897
Gima (Grocery stores)						
Public offering	54.68	4.15	Public offering	3-4.06.1991	406,902	283
Block sale	50.38	94.05	Bilfer-Dedeman	02.03.1993	21,787,413	
Teletaş (Telecommunications)						
Block sale	40.00	22.00	Public offering	29.02-2.03.1988	13,090,225	41,695
Halka Arz	18.00	18.00	Alcatel B.V.	19.08.1993	21,002,400	
Uşaş (Airport services)						
Block sale	100.00	70.00	SAS	09.02.1989	14,450,000	
Public offering	30.00	30.00	Public offering	20-22.10.1993	15,205,871	4,672
Petrol Ofisi A.Ş. (Petroleum distribution)						
Public offering	100.00	4.02	Public offering	27-29.5.1991	14,386,888	17,206
Block sale	93.30	51.00	İş Doğan A.Ş.	21.07.2000	1,260,000,000	
Public offering	42.30	13.00	Public offering	27.02-15.03.2002	129,479,256	51,470
Total					1,747,747,798	167,590
Public offering					241,548,765	
Block sale					1,506,199,033	

Source: Compiled and re-arranged from tables of Privatization Administration in Turkey.

public offering of Turk Telekom's shares. The block sale to a strategic investor requires participation of an international telecommunications operator that would bring expertise and accelerate the commercialization of Turk Telekom (Aybar *et al.*, 2001). The steps involved in the privatization of this enterprise would include a financial review, valuation, a decision regarding an appropriate method of investment, invitation of bids and screening of prospective investors, negotiations with short-listed firms and final recommendation to cabinet for approval (Karataş, 2001). Unfortunately, sales of minority shares of Turk Telekom did not attract foreign investors as it was hoped due to obscure management rights (*Financial Times*, 18.09.2000).

Reconsidering the percentage of ownership stake to be offered to strategic partners and the controversial management rights the government authorized the block sale of 33.5 percent of the company in December 2000. The tender committee was to expect offers till May 14, 2001. However the financial crisis triggered by a confrontation between the prime minister and the president led to a collapse of the December 1999 Stand By Agreement with the IMF and the tender was cancelled. Since the uncertainty about management rights would be an obstacle to a successful privatization in by then a depressed global telecom market, it was proposed that a minimum of 51 percent of Turk Telekom's shares be privatized.

The privatization process gained momentum following the November 2002 elections which drastically altered the political landscape of Turkey. None of the ruling coalition parties received enough votes to be represented in Parliament, while a brand new party was able to form a majority government by itself. The Council of Minister Decree – dated November 13, 2003 stipulated that a minimum 51 percent of Turk Telekom shares were to be offered block, while remaining shares would be offered to public following the block sale. With the enactment of law 5189, the foreign ownership restriction on the part of foreign investors was lifted, the scope of the golden share has been limited and the satellite business has been taken out of Turk Telekom to function as a separate public entity (OIB, 2005).

The formal tender process for the block sale of 55 percent of Turk Telekom commenced with the tender announcements on November 25, 2004. Accordingly, to be able to submit bids, bidders would be required to satisfy the pre-qualification criteria determined by the Tender Committee. Applications for pre-qualification were delivered to the Privatization Administration on January 11, 2005 where 13 national and international bidders qualified. The bidding deadline for the tender is May 31, 2005 (OIB, 2005).

Objectives of Turkish privatization: what has been achieved?

The primary objectives of the privatization program were to (1) minimize state involvement in economic activities; (2) promote competition, improve efficiency and increase the productivity of public enterprises; (3) relieve the state from the burdens of inefficient state industries; (4) facilitate a wider distribution of

share-ownership and develop a viable capital market and; (5) create revenue for the government. In this section, we review evidence on to the achievements of Turkish privatization with respect to these objectives.

State's involvement in economic activities

According to the Privatization Administration Statistics the following privatization implementations have been realized since the start of privatization process in 1985:

- State completely withdrew from cement, animal feed production, milk-dairy products, forest products, civil handling and catering services, and petroleum distribution sectors.
- More than 50 percent of the state shares were privatized in tourism, iron and steel, textile, sea freight, and meat processing sectors.
- State has partially withdrawn from the ports and petroleum refinery sector.
- Privatization of public banks has commenced with Sümerbank and continued with Etibank, Denizbank, and Anadolu Bank. The international and domestic offering of the 12.3 percent state shares in İşBank in May 1998, had been the largest public offering in Turkey until that time and recorded as one of the largest privatization proceeds among the emerging European markets.
- Public shares in Netas (telecommunication firm) and Tofas (auto manufacturer) were issued to foreign investors through international public offering for the first time, which served as a driving force of the integration of ISE with foreign capital markets.
- Public shares in many companies were issued to the public, particularly in the beginning of this decade and this enhanced the institutionalization of ISE.
- 14.95 percent of the Turkish Airlines has been privatized in an International and Domestic Offering in December 2004, sales amounting to \$126 million.

An appropriate measure to assess the degree of state involvement in economic activities is the share of public sector in total value-added manufacturing. Figure 9.2 shows the share of public sector and of private sector in total value-added annually for the 1985–2000 period, every 5 years for the 1970–1985 period and every 10 years for the 1950–1970 period. Data is compiled from the State Statistics Institute's Statistical Indicators (Istatistiki Göstergeler 1923–2002, DIE). The share of public sector is practically unchanged between 1950–1960 and is almost 60 percent of total value added. In the next 25 years, it falls by 34 percent to about 40 percent of total value added. The reduction in the share of public sector is significantly faster in the post-privatization period. The share of public sector is down from 40 percent in 1986 to 18.5 percent in 2000, which is a 54 percent reduction. Since the rate of reduction in the share of public sector in total value added is significantly faster in the post privatization period than in the decades prior to 1985, we can conclude that the privatization program appears to

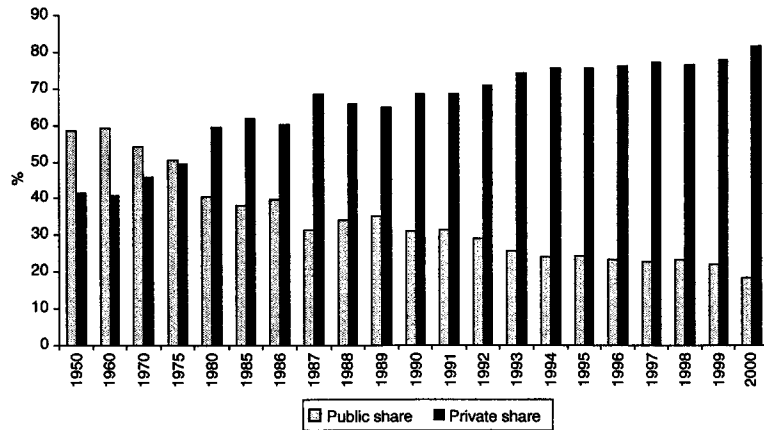


Figure 9.2 Share of public and private sector in total manufacturing value-added.

have been – at least partially – successful in achieving its objective of reducing the state's involvement in economic activities. However the privatization process has been slower compared with the principal Latin American and Eastern European cases and is yet to be completed.

Privatization and efficiency

In the case of the cement industry, there are relatively large numbers of state-owned plants that were sold during the 1989–1998 period, and hence sufficient time has elapsed for proper empirical analysis. Since almost all empirical studies on the Turkish privatization experience have focused on this industry, we will examine the privatization process in this industry and then discuss the findings of empirical studies.

Privatization in the cement industry

The first cement plant of Turkey was established in 1911 by a private firm. By 1950, four more private plants had been built. Only after 1950 did the cement industry develop on a large scale by means of a government initiative. A public enterprise, CİSAN (Turkish acronym for Turkish Cement Industry Co. later named CİTOSAN), was established in 1953 to build 15 plants in various regions. Before the privatization of the cement plants began in 1989, the public share in the cement industry was nearly 40 percent (Saygılı and Taymaz, 2001). It is believed that each company was able to exercise some monopoly power within its hinterland (Ertuna, 1998), most probably due to the distance between firms and the lack of proper transportation facilities in the public sector.

In 1986 a French company, Sema-Metra Conceil was contracted by the Turkish government and the World Bank to prepare two reports, one on the structural regulation of the cement sector and privatization and the other on the plan for the reorganization of CİTOSAN. In the latter report, Sema-Metra Conceil suggested that plants in the west be privatized first since they could be as profitable as private plants, and recommended that the eastern plants be restructured prior to privatization. The report also suggested privatization on a plant-by-plant basis, as the sale of the state firm as a single entity may have led to an unhealthy monopoly (Tallant, 1993). In 1986 there was a major change in the economic environment of the cement plants. Prior to 1986, the Turkish Cement Producers' Association (TCPA) set prices and market areas for all cement companies, however after 1986 firms were encouraged to operate independently and maximize profits. Sema-Metra's first report might have partially led to this change.

Privatization in the cement industry started in 1989, with the initial sale of five factories to the French firm Cement Francais (SCF). By 1998, the sale of 22 cement plants had been completed.⁴ The recommendations of the Sema-Metra report were taken into consideration, and the western plants were privatized first.⁵ It may also be the case that the privatization of the eastern plants was delayed, as the eastern region suffered from unemployment and terrorism throughout the 1990s, and the public enterprises were used as means of employment.

Privatization of the cement plants was carried out under the Privatization Administration of Turkey. Most of the privatizations were realized through block sales using closed-bid auctions and through a combination of block sales and public offerings in a few cases. Public sector employment was guaranteed to all workers that lost their jobs because of privatization. Hence there were no disposal costs of workers for the buyers of the privatized firms.

Saygılı and Taymaz (2001) point out that, holding companies had a tendency to acquire plants in specific regions. For instance, Rumeli Holding bought plants in the eastern region and along the Black Sea coast. The Turkish Armed Forces Pension Fund (OYAK) and Sabancı Holding; one of the biggest conglomerates in Turkey formed an alliance and purchased companies in the Central Anatolia, Southern Anatolia, and Marmara regions. Set Cement Holding (a subsidiary of Italcementi which merged with Ciment Francais) focused on Central and Western regions, and finally, Lafarge and Yibitas bought cement plants in neighboring provinces of Central Anatolia. Saygılı and Taymaz (2001) argue that, privatization through block sales, instead of public offerings in the stock market, gave rise to bigger regional monopolies. According to the report of the Central Anatolian Board of Export, however, the privatization of public cement plants increased competition in the industry and decreased prices.

Today, the Turkish cement industry consists of 39 private plants, some owned by giant industrial conglomerates and others by small one-plant companies. There are four foreign investors in the industry, namely, French Lafarge Coppee, Ciment Vicat, German Heidelberger Zement/CBR, and Italian Italcementi. Cement consumption continues to grow at sound levels and Turkey continues to be a major exporter of cement. According to the report of the Central Anatolian

Board of Export, in 1998 Turkey was the largest cement producer in Europe and seventh in the world (OAI, Cimento Sektoru Raporu, 1998).

Empirical studies of the cement industry

There are several empirical studies that analyze the impact of privatization on the Turkish cement industry due to availability of pre- and post-privatization data for this sector (Çakmak and Zaim, 1992; Tallant, 1993; Karataş, 1995; Özmucur, 1998; Saygili and Taymaz, 2001; Ökten and Arin, 2005). Most of these studies only analyze how privatization affects firm efficiency and yield somewhat mixed results. Ökten and Arin (2005) also analyze how privatization affects allocative efficiency.

We can classify these studies into two groups. In the first group, studies compare the performance of *public versus private plants* and yield mixed results (Çakmak and Zaim, 1992; Tallant, 1993; Saygili and Taymaz, 2001). In the second group, studies compare *pre and post privatization* performance of privatized plants and present a more clear picture (Karataş, 1995; Özmucur, 1998; Ökten and Arin, 2005). All of these studies report a significant improvement in labor productivity in the post privatization period. We now analyze the studies in the first group in more detail.

Çakmak and Zaim (1992) compare the efficiency of private and public plants in 1985. They employ the stochastic production frontier approach to estimate the production frontier and technical efficiency at the plant level. Their input variables in the production process are value of expenditures for labor use, value of expenditures for energy use and depreciation on capital. Their findings suggest that private plants on average are no more efficient than public plants.

Tallant (1993) analyzes the relative efficiency of the public sector with respect to the private sector in Turkish cement industry in a cross-sectional study. He finds that private plants are more efficient in terms of labor productivity and capacity utilization. However, he argues that the better showing in physical measures is closely related to geographic location as western plants perform better which indicates that the initial location decision has had more to do with firm performance than public ownership per se. Tallant also analyzes financial measures of efficiency and finds that ratio of operating profit to net sales revenues is less for state owned plants than in private ones. However by his own account he is skeptical of financial measures as he states that Turkish financial measures are not detailed, accounting standards tend to vary and financial disclosures do not provide a complete picture of the firms' financial health.

Saygili and Taymaz (2001) analyze the effects of ownership and privatization on technical efficiency using a panel data set of public and private cement plants for the years 1980–1995. They have a sample of 13 private plants, 14 privatized plants, and 6 publicly owned plants during their period of study. They use dummy variables for these ownership categories omitting the dummy for public plants and estimate the effects of ownership on technical efficiency relative to the omitted dummy variable. In other words, they measure the relative performance of private or privatized plants with respect to the plants that remain public during the

study period (until 1995). They estimate a stochastic frontier production function and the efficiency effects model simultaneously.

They find that private plants were clearly more efficient than state-owned plants privatized after 1995 but a comparison of the average technical efficiency of private plants and public plants privatized in 1989 reveals no statistically significant difference. Their conclusion is that privatization authorities started the privatization process with the most efficient state-owned plants and the post-privatization performance of these “better” plants did not show any significant improvement. Their conclusion has a similarity to that of Tallant study in that public plants located in the east and privatized later during the process perform more poorly than private plants.

We now examine the studies in the second group. Karataş (1995) uses data collected by Istanbul Chamber of Industry and observes an improvement in labor productivity but consistently poor financial performance of the five plants privatized in 1989.

Özmucur (1998) analyzes a panel of public and private cement plants, using the results of the Istanbul Chamber of Industry 500 largest firms of Turkey surveys. He estimates a separate equation for each plant to determine the year of structural change for employment and labor productivity for the 1981–1995 period. He finds that structural change coincided with time of privatization for public plants and reduction in employment which to a degree happened in all plants was significantly higher in the privatized plants.

Ökten and Arin (2005) analyze the effects of privatization on firm productivity and allocative efficiency using a panel data set of 22 privatized cement plants during 1983–1999 period. The data set enables the authors to avoid the endogeneity problem associated with sample selection. All public cement plants in Turkey have been privatized by 1998 and the authors have pre- and post-privatization data for all. They use firm fixed effects and yearly dummies to control for period specific effects in their baseline specification. The results show that privatization increases labor productivity and decreases prices significantly indicating an improvement in both productive and allocative efficiency.

Their results on productive efficiency are robust to controlling for changes in the competitive environment (market structure) using a regional Herfindahl Index (HHI) while privatization has no longer a significant effect on prices in the presence of this control. This highlights the importance of market structure and competitive environment following privatization. They also find evidence that production technology becomes more capital intensive as the capital endowment, investment and capital labor ratios increase following privatization.

How can we reconcile the differences in results as to the effects of privatization on firm efficiency? One explanation can be the differences in the competitive environment in which public plants operate in. Before the start of privatization, there are many private plants in the western regions while few exist in the eastern regions. Hence public plants located in the east face little competition from private plants. Figure 9.3 presents the Herfindahl Index for Marmara (west) and Eastern Anatolia (east) regions (Ökten and Arin, 2005). HHI is calculated by

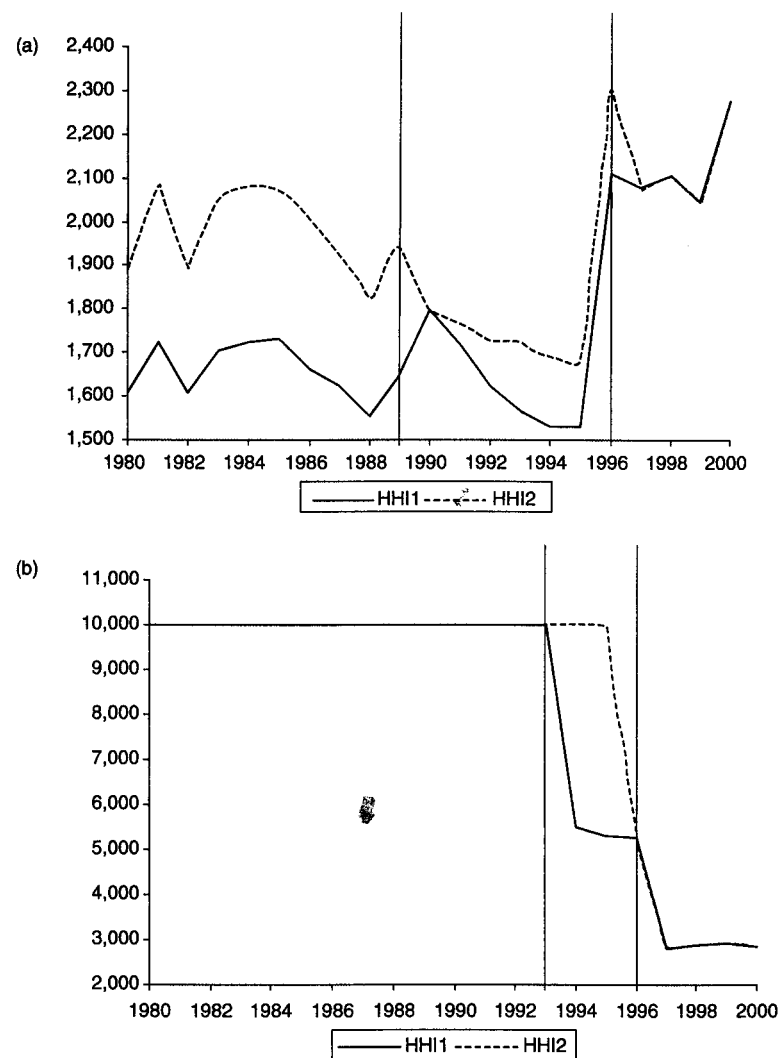


Figure 9.3 Market concentration measured by Herfindahl Index: (a) Marmara (west) region, (b) Eastern Anatolia (east) region.

summing the squares of market shares of plants in each region. If two or more plants are owned by the same parent company, then market share of the parent company in region is used in the calculation. The higher the HHI, the more concentrated the market.

In the graphs, HHI(1) is the Herfindahl index including the publicly owned plants and HHI(2) is the Herfindahl index excluding the publicly owned plants. In calculating HHI(1), share of output sold by publicly owned plants is considered as the share of a single firm – the public enterprise in that region. In calculating HHI(2), only output sold by privately owned plants is considered. Vertical lines indicate the years of privatizations.

From Figure 9.3, HHI(1) for Marmara Region has ranged between 1,600 and 2,300 during 1980–2000 period and actually increased after privatization. In contrast, public plants in the eastern region formed a monopoly prior to the start of the privatization process since no private plants existed in this region. The four public plants were privatized in 1993 and 1996 and HHI dropped significantly – from 10,000 to 3,000 – as each plant was sold to a different company. Hence the lack of competition from the private sector, might be responsible for poor performance of public plants located in the east and the relatively more competitive environment in the west might be responsible for the better performance of public plants located in the west.

Another possible explanation for the differences in findings is that studies are measuring short-run effects of privatization and while there is a significant improvement in labor productivity in the short-run, there are few changes in total productivity. We should note that, according to the Ökten and Arin (2005) study, capital and investment are increasing after privatization. This might indicate that plants are switching to more capital intensive technologies. These technologies might be more cost efficient in the long-run than labor intensive technologies, although both types of technologies are on the production possibilities frontier. Furthermore, the effects of investment in capital and technology might be observed with a lag. Hence a study that spans a longer post-privatization period may help reconcile some of the differences in results.

Ökten and Arin (2005) study is the only study that examines the effect of privatization on allocative efficiency of the cement industry. Their measures for allocative efficiency are plant specific cement prices (in log) and the relative inflation rate. The relative inflation rate is calculated by subtracting the wholesale price index inflation rate from the plant specific price inflation rate. Prior to the price de-regulation in 1986, the price of each publicly owned plant was set to the same amount by CITOSAN, the Public Enterprise. The authors lack data on these prices but have an industry-wide price index from the State Planning Institute of Turkey. Hence, they calculate the plant specific price inflation rate by using this industry-wide price index prior to 1986, and by using plant specific prices after 1986. Since this variable merely indicates rate of change, it is possible to construct it using two different price indices as long as we code the year for which we switch from one index to the next as missing. Their goal in constructing relative inflation rate is to achieve a longer series on price.

Both regressions, plant specific cement prices and the relative inflation rate, control for firm specific and period specific effects by adopting a firm fixed effect specification and including year dummies. The authors find that privatization decreases both cement prices and the relative inflation rate. A switch from public ownership to private ownership decreases cement prices by 32 percent.

Revenue generation and share ownership

Since its start in 1985, the total proceeds from privatization efforts have amounted to \$9.4 billion by 2004. Block sales via auctions have been the most prevalent method of privatization. There is only one empirical study that analyzes the determinants of privatization prices in Turkey (Arin and Ökten, 2003). The authors use a data set of 68 privatized firms from Turkey gathered from official statistics of the Privatization Administration. The sample includes 24 cement plants/grinding facilities, 29 dairy product plants, 4 ports, 3 marinas, 2 airline service firms, and 6 heavy industry manufacturers like mining and metal firms, which were privatized in Turkey between the years 1989 and 1998. In that sample, 65 out of 68 firms are sold through block sales via auctions. The remaining 3 firms are sold through a combination of block sales and public offerings.

Interestingly, the authors find that revenues affect privatization prices, not profits and hence argue that what fundamentally determines the privatization price is the expected future profit of the firm. Potential buyers would discount firms' current cost information if they believe that these firms were inefficient. Current costs and hence profits do not affect privatization prices because they do not reflect expected future profits, whereas revenue and market characteristics are good indicators for future profitability. Firms' profit margins have positive and significant effects on privatization prices when the whole heterogeneous sample is used similar to findings for Mexico by Lopez-De-Silanes (1997). However, when authors concentrate on a single industry (cement industry), this variable is no longer significant. Therefore, their interpretation for the effect of this variable is different from that of Lopez-De-Silanes. They argue that profit margins measure the differences in market power of firms in different industries (market structures) rather than differences in firm efficiency and this is what gets reflected in privatization prices. Arin and Ökten (2003) find that the number of bidders increases privatization prices consistent with the results for Mexico.

Sales of SOEs through public offerings have been utilized on a limited scale. The limited size and depth of the ISE has undoubtedly restricted the sale of SOEs by public offerings. Hence one could argue that, the objectives of wider share ownership and developing a viable capital market have not been met. However, share issue privatizations include some of the largest SOEs as can be seen from Tables 9.2 and 9.3.

Concluding remarks

Economic theory specifies a role for state ownership only in natural monopoly type of market structures where efficiency requires a single firm to exist. Even then, state ownership may not improve efficiency if SOEs pursue other objectives due to political or bureaucratic pressure (Vickers and Yarrow, 1988; Shleifer and Vishny, 1994).

Historically, Turkey has had a long experience of relying heavily on SOEs even in markets that can not be characterized as a natural monopoly. SOEs were established during the 1930s by the government to jump-start the economy that collapsed with the end of the Ottoman era in 1923. SOEs grew enormously over the years and

served as engines of economic activity in the absence of a strong private sector. By 1960, share of public sector in total value added in manufacturing was 60 percent.

By the 1980s, SOEs began to be perceived negatively due to poor financial performance, overstaffing, dependence on subsidies, protected markets, and corruption. Hence, privatization came into the political agenda first with Prime Minister Özal's trade and capital account liberalization program in 1984. Despite the initial enthusiasm, it is not surprising that privatization of SOEs was a slow process. The preferences that created and promoted SOEs were also reflected in the country's laws and institutions that challenged many privatization attempts. Still, a large number of SOEs and state shares in companies have been divested between 1985 and 2005 and the total proceeds have amounted to \$9.4 billion.

Block sales have been the most prevalent method of privatization. One could argue that this policy contradicts with the aim of developing a viable capital market and facilitating a wider distribution of share ownership. Arin and Ökten (2003) analyze the determinants of privatization prices in block sales via auctions and find that revenue and market characteristics affect privatization prices, not profits and argue that what fundamentally determines the privatization price is the expected future profit of the firm. They also find that competition measured by the number of bidders increases privatization prices.

There are several empirical studies that analyze the impact of privatization on the Turkish cement industry due to availability of pre- and post-privatization data for this sector (Çakmak and Zaim, 1992; Tallant, 1993; Karataş, 1995; Özmucur, 1998; Saygılı and Taymaz, 2001; Ökten and Arin, 2005). Results of these studies are mixed on the effects of privatization on firm efficiency. Studies that span a longer post-privatization period and consider the links between ownership type and the competitive environment are needed to reconcile differences.

Notes

- 1 A survey by Djankov and Murrell (2002) examines the effects of privatization in transition economies. They conclude that in most countries, privately owned firms perform better than state-owned firms.
- 2 Bartero and Rondi (2000) show that consistent with theoretical predictions, Italian state-owned firms respond to financial pressure under a hard budget constraint by increasing total factor productivity and reducing employment whereas no such positive effect is observed under a soft budget constraint.
- 3 This is an interesting case. In July 1998, PA High Council reversed its previous decision that favored the offer of \$1.6 billion by the highest bidder, the Akmaya-Orteks AS group and decided to sell 51 percent of POAS to the third highest bidder, the İşBank, Park Holding, Bayindir and PUIS consortium group. This group agreed to raise its initial bid to the level of the highest bid. Nevertheless, the privatization of POAS was suspended by the Ankara Supreme Court, as the privatization deal was deemed to be against the Constitution and the principle of wider share ownership. The partial sale of POAS took place in March 2000 after the legal framework has been prepared for its divestment (Karataş, 2001).
- 4 Also privatized were the two cement grinding facilities.
- 5 Two exceptions were Denizli and Lalapasa. These two public plants were established in 1987 and 1991 respectively, in order to meet the growing demand in the western regions.

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