TITLE THE PRIVATISATION OF STATE ECONOMIC ENTERPRISES : AN ECONOMIC AND POLITICAL ANALYSIS OF THE TURKISH CASE

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The Privatisation of State Economic Enterprises: An Economic and Political Analysis of the Turkish Case

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DEDICATION

This thesis is dedicated to an honourable gentleman, Mr. Mordo Dinar, from whom I have learned so many important things in life and whom I owe so much. Without him all this would not have been possible.

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DECLARATION

I hereby declare that the material contained and all the results presented in this thesis were obtained by myself under the supervision of Professor Wyn Grant. Thus this thesis is the work solely of the author. None of the material and/or the results has been submitted previously for a degree in this or any other university.

Mustafa DAVUTOGLU

ABSTRACT

This study is an economic and political analysis of the privatisation of state economic enterprises (SEEs) in Turkey between 1986-1996. A radical shift from planned to a market economy is observed in Turkish economic policy which occurred during the 1980s as a response to the crisis of the late 1970s.

Privatisation has been one of the major elements of this new economic policy. The initial impetus towards privatisation sprang from dissatisfaction with the performance of SEEs. Attempts have been made to change the nature and the role of the public sector in the Turkish economy. It was hoped that privatisation would improve the economic performance of the SEEs by freeing them from direct state intervention and exposing them to the market forces.

Within the above perspective, this thesis provides a case study of the Turkish experience with privatisation by examining the concept based on an analytical framework. After a decade of privatisation efforts, the results of the Turkish privatisation look disappointing. The study identifies political, economic and social factors as the major influences that determined the outcome of privatisation in the Turkish context. This work suggests that the implementation of successful privatisation policies hinges on the ability and capacity of the political leadership to control the bargaining process. It appears to be essential for governments to form a strong coalition which embraces support from the public and various interest groups to promote and implement the privatisation programme smoothly. The Turkish case shows that the government's failure to control the process combined with other factors such as an unfavourable macroeconomic environment and an inefficient institutional framework all contributed to the unsuccessful outcome of its privatisation policy.

In the empirical part of the research, the efficiency of the privatised firms in terms of their profitability and productivity are evaluated. The findings from the case studies show that there are significant improvements in the performance of the privatised enterprises in Turkey following privatisation. Though some poor financial performance is observed in the eight privatised enterprises studied, in general all of them have recorded significant improvements in labour productivity. There is also evidence that attempts to reduce the role of the public sector as the supplier of goods and services in Turkish cement, airline catering and telecom equipment manufacturing sectors have been largely successful. Hence, it is now widely acknowledged that the private sector can perform in these areas more efficiently and at a lower cost and offer better quality goods and services than the public sector.

The study has two major conclusions. The first is that privatisation is an economic and political issue. As the Turkish case illustrates, politics plays the most important role in deciding whether or not to privatise and the outcome of privatisation policies. However, the economic justification of privatisation, which rests upon the potential improvements in efficiency, which come from greater competition, appear to be the main objective of most privatisation programmes.

The second conclusion is that privatisation is not a panacea for all the economic problems that governments face, but as the successful privatisation examples show it is a way forward to promote economic efficiency at the both enterprise and macroeconomic levels. Most important of all, a radical privatisation programme can significantly reduce the state intervention in the management of the economy and eliminate the issues of political patronage, rent-seeking and favouritism especially in developing countries.

LIST of ABBREVIATIONS and ACRONYMS

CPEs	Centrally Planned Economies
DP	Democrat Party
EBFs	Extra Budgetary Funds
GDP	Gross Domestic Product
GNP	Gross National Product
ICI	Istanbul Chamber of Industry (ISO)
IMF	International Monetary Fund
ISE	Istanbul Stock Exchange (IMKB)
ISI	Import Substituting Industrialisation
LDCs	Less Developed Countries
MHPPA	Mass Housing and Public Participation Fund
MNCs	Multinational Corporations
MP	Motherland Party (ANAP)
OYAK	Armed Forces Benevolent Fund
PA	Privatisation Administration (ÖIB)
PHC	Privatisation High Council
PPA	Public Participation Administration (KOI)
PPF	Public Participation Fund
PPHC	Public Participation High Council
PSBR	Public Sector Borrowing Requirement
RPP	Republican People's Party (CHP)
RSCs	Revenue Sharing Certificates
SAA	State Airports Administration (DHMI)
SAS	Scandinavian Airlines System
SCF	Societe Ciment Francais
SDPP	Social Democrat Populist Party (SHP)
SEEs	State Economic Enterprises
SIS	State Institute of Statistics (DIE)
SOEs	State-Owned Enterprises
SPO	State Planning Organisation (DPT)
SSP	SAS Service Partner
THY	Turkish Airlines (Türk Hava Yollari)
TL	Turkish Lira
TPP	True Path Party (DYP)
TÜSIAD	Turkish Industrialists' and Businessmen's Association
WPI	Wholesale Price Index (TEFE)

LIST OF INTERVIEWS

A total number of 27 semi-structured personal interviews were carried out for this research between September 1995 and September 1996. Seven of the interviewees wished to remain anonymous. Otherwise, the people and organisations represented by the interviews are listed below.

- Mr. Yves Marie LAOUNENAN, Private Consultant on Privatisation, Istanbul, 1 September 1995.
- Ms. Emel VARLI, Branch Manager, Privatisation Administration, Ankara, 11 September 1995.
- Ms. Tülay AKTAS, Privatisation Administration, Ankara, 11 September 1995 and 23 Sept. 1996.
- Ms. Dilek EMIL, Head of Department, The Undersecretariat of the Treasury, General Directorate of SEEs, Ankara, 12 September 1995.
- Prof. Dr. Halil SARIASLAN, Advisor to the President of TOBB and author of several reports on privatisation, Ankara, 12 September 1995.
- Mr. R. Hakan ÖZYILDIZ, General Director of SEEs, The Undersecretariat of the Treasury, General Directorate of SEEs, Ankara, 13 September 1995
- Mr. Metin KILCI, State Planning Organisation (SPO), Ankara, 15 September 1995.
- Mr. Tom HERTEL, General Manager, USAS, Istanbul, 19 September 1995.
- Mr. Tevfik ALTINOK, Chairman, Finance Group, Koç Holding and former Undersecretary of the Treasury, Istanbul, 20 September 1995
- Mr. Kamil SATIROGLU, Vice Chairman and Chief Financial Officer, SET Group, Istanbul, 21 September 1995
- Ms. Selva HATIBOGLU, Finance Manager, Alcatel Teletas, Istanbul, 21 September 1995.
- Mr. Abdurrahman ARIMAN, General Secretary, Association for Foreign Capital Coordination (YASED), Istanbul, 21 December 1995.
- Mr. N. Kemal ERTEN, Head of Istanbul Region, Çimse-Is Union, Istanbul, 3 January 1996
- Mr. Lütfi YENEL, General Manager, Alcatel Teletas, Istanbul, 4 January 1996
- Mr. Cemail BAKINDI, Chairman, TOLEYIS Union, Istanbul, 4 January 1996.
- Mr. Durmus TOPRAK, General Secretary, TOLEYIS Union, Istanbul, 4 January 1996
- Mr. Haluk MENEKSE, Assistant Manager, USAS, Istanbul, 5 January 1996
- Mr. Turgay AKAN, Expert, PA, Ankara, 23 September 1996.
- Mr. Murat KURAL, Board Member in Türk Telecom and Division Manager in PA, Ankara, 23 September 1996.
- Mr. Arda AKARSU, Expert, PA, Ankara. 23 September 1996

INTRODUCTION

Introduction

This thesis examines the privatisation of state economic enterprises (SEEs) in Turkey from an economic and political perspective. The study attempts to evaluate systematically the privatisations that have been undertaken in different sectors of the Turkish economy since 1986. In the ten years up to 1996, the overall record of privatisation in Turkey has been an unsuccessful one. Hence, this study examines the reasons for the failure of the privatisation programme in the context of the political economy of the country. In the empirical sections of the thesis, the effects of privatisation on the performance of eight privatised companies in three different sectors are assessed.

Governments throughout the world grew rapidly in size and their functions extended in the period stretching from the 1950s to the late 1970s. They assumed a greater role in the economic life of most industrial and developing countries during the period in question. The SEEs were one of the policy tools available to the state to achieve its economic, social and political goals. Governments assigned to SEEs specific forms of institutional roles in their development strategy. Consequently, the share of SEEs in national output and investment expanded significantly in many developed and in almost all developing countries. This rapid expansion of the public sector throughout the world faced little adverse reaction; rather, it was considered beneficial in terms of economic, social and political outcomes.

The late 1970s and early 1980s, however, brought about a fundamental reassessment of both the role of SEEs and their importance in the process of development. Following the oil crisis, the non-oil economies started to encounter serious macroeconomic imbalances. It was during this period that, in contrast to the interventionist approach of the 1950s and 1960s, the neoclassical perspective put forward a policy prescription which aimed at a reduction in the size of the public sector, the removal of government regulation and controls, the fostering of competition, and a greater reliance upon the price mechanism for the allocation of resources. Besides this ideological shift, there was a widespread belief that SEEs around the world had a very poor record of performance, and by and large, they failed to generate a surplus for the economies in which they operated. Most SEEs became inefficient and their financial losses had to be subsidised from the budget or through external borrowing which was not easily available in the 1980s anymore.

As a consequence of the changes in the ideological climate and dissatisfaction with the performance of SEEs, attempts were made to reduce the size and the role of the public sector in the economy in many countries. The privatisation of SEEs has featured prominently in these attempts as a solution to the immediate problems that most economies were confronting in the 1980s.

The policy objectives and motives for privatisation varied between countries and have been altered with time. In the case of most industrialised countries (e.g. Britain and France), it could be argued that in the 1980s the dominant motive was an ideological one, while issues of economic efficiency are also cited as important objectives of the policy. Privatisation first gained popularity in the UK with the Thatcher government in the early 1980s. It was notable in both its scale and its high national and international profile (Bishop and Kay, 1989; Heald, 1988b). In the late

1980s and 1990s, the trend towards privatisation appeared to be world-wide, covering both developed and developing countries, rich and poor ones as privatisation policies were embraced enthusiastically by most governments in developed countries as well as the governments of the transitional economies of Eastern European countries (Vickers and Wright, 1988; Cook and Kirkpatrick, 1988; Ramamurti, 1992).

Privatisation extended quickly to the developing world mainly under the impetus of strong support from the international donor community, particularly the World Bank and the International Monetary Fund (IMF). Privatisation was linked with the macroeconomic burden of the SEE sector in developing countries. SEEs were seen as an important factor to ever rising fiscal imbalances. The World Bank and the IMF influenced many countries to reduce public expenditures and to adopt policies that would foster efficient use of resources and bring about growth within the framework of the stabilization policies (Babai, 1988; World Bank, 1995).

Among the developing countries, the Turkish experience in privatisation began a decade ago, yet it has been implemented discontinuously due to serious political and institutional obstacles. The notion of privatisation first appeared in the austerity package of the 24 January Decisions in 1980 which aimed at a massive restructuring of the economy emphasised on export-oriented growth strategies and greater reliance on market forces. This new liberal ideology and the idea of privatisation gained momentum and became the policy of the Motherland Party in 1983 under the "neo-liberal economics" ideology similar to those pursued in the UK.

After a decade of privatisation efforts, the results of the Turkish privatisation look disappointing. Not a single major state enterprise has been fully privatised yet. The total revenues of Turkish privatisation over the last ten years amount to around $3.1 billion and this represents only 2.3 per cent of the Turkish GNP. Moreover,

during this period the Turkish privatisation has undergone significant changes in terms of its objectives, methods and assumptions. Today, it is clear that the Turkish privatisation policy has shifted away from its original goals of competition, efficiency, wider share ownership and it has become a revenue generating policy tool for the government.

Therefore, an opportunity exists to examine the economic and political motives for the privatisation policies in a middle-income developing country context, Turkey, and the reasons for their failure. In Turkey, efforts to diminish the role of the public sector as the supplier of goods and services in three sectors; cement, airline catering and telecommunication equipment manufacturing have been largely successful. It is now widely acknowledged that the private sector can perform in these areas more efficiently and at a lower cost to the consumer than the public sector in terms of the provision of goods and services needed. Thus, in the empirical part of this thesis, the theoretical argument is tested by examining the performance of eight privatised enterprises in the sectors mentioned above before and after their privatisation. This will allow the researcher to find out the effects of the privatisation on the performance of the enterprises studied. The case studies will focus on the changes realised as a result of privatisations such as improved economic efficiency in the form of profitability and productivity, lower good and service prices, increased competition as well as the social impact of privatisation in terms of employment and environmental protection.

Methodology of the Study

The choice of the subject matter of this thesis was largely influenced by the fact that, firstly, since the 1980s, a major process of redefinition of the role of the state has

been underway in many countries. The concept of 'privatisation' is a central component of this process; deregulation of markets is another one in the political economy of numerous developed and developing countries. A second consideration was the lack of research undertaken on the Turkish privatisation experiment.

Available writings on the subject of privatisation in the Turkish context tend to examine the subject from either a narrow perspective or they just concentrate on specific cases. It is my contention that most of these studies done so far also lack a serious theoretical setting. Thus in this study I have intended to analyse the subject from an economic and political perspective by placing it within the context of an appropriate analytical framework.

Furthermore, in contrast to other studies, especially the ones done in industrialised countries where most research on privatisation is either complementary to or repetitious of previous studies, any research conducted in Turkey about the privatisation programme and its empirical results at this stage is bound to be by definition original and creative and in itself a significant contribution to knowledge.

Some of the data and other sources of materials used in this study will be documentary and secondary such as official publications, legislation in the area, newspapers, published books and articles related to the subject. The study will be also based on data and information gathered through fieldwork, based on financial analysis of the companies studied and interviews carried out in Turkey. In particular, given the current dynamic nature of the privatisation process, a total number of 27 semi-structured interviews were conducted with the management of privatised companies, Privatisation Administration (PA) and government officials as well as policy makers

who are or have been involved in the privatisation process in Turkey.[1] Data collected from the interviews conducted tends to be mostly qualitative rather than quantitative. In the whole, however, interviews conducted during the field research offered the opportunity to come into contact with professionals in the field of study and these interviews proved enlightening in the course of this research study.

Plan of the Thesis

The thesis altogether consists of nine chapters. Following this introductory chapter, *Chapter One* establishes an analytical framework for the study in order to organise conceptually many factors often cited in the literature on privatisation. The chapter briefly outlines the role played by the state in economic development and in the emergence of SEEs before proceeding to the analysis of privatisation. The analysis is centred around economic and political aspects of privatisation.

Chapter Two looks at the development of SEEs in Turkey within the context of national economic development based on the ideology of 'etatism'. It shows how the policy of etatism was vigourously implemented until the 1980s and SEEs became important economic units within the Turkish economy. *Chapter Three* examines the political and economic changes which took place in the 1980s. An in depth analysis of the 1980 economic stabilization and liberalisation policies and their impact, including the emergence of the public sector reform and privatisation, on the Turkish economy is provided. The chapter ends with a general account of the Turkish political economy in the 1980s and early 1990s.

[1] Details of the methodology used in the empirical studies are explained in Chapter 5. See p.xi for the list of interviews.

A detailed and comprehensive analysis of the Turkish privatisation is presented in *Chapter Four*. This chapter includes the implementation of the privatisation programme up to date, difficulties encountered and different privatisation strategies employed by the government to privatise. In its final section, this chapter explains why the privatisation programme as a whole has not been very successful in Turkey.

Chapter Five sets out a methodological framework for the three empirical chapters where the effects of privatisation on the performance of the eight Turkish companies in three different sectors are assessed. It explains the selection of the samples, the methodological approach used and the calculation of data for the case studies. The empirical part of the thesis is divided into three chapters.

Chapter Six starts with the examination of privatisation in the Turkish cement industry and its impact on the sector. The particular objective of the chapter is to analyse the performance of the five privatised cement plants in terms of their efficiency gains and improved productivity.

Similarly, *Chapter Seven* and *Eight* concentrate on the privatisations of the companies in the airline catering and telecommunications equipment manufacturing sectors respectively. The performance of three privatised enterprises by using profitability and productivity measures is examined.

The last part of the thesis, *Chapter Nine*, is the summary and conclusions where the empirical findings are related to the theoretical argument on privatisation. It draws some conclusions from the Turkish privatisation experience and it makes recommendations for the future of the privatisation programme in Turkey.

CHAPTER 1: Privatisation: An Analytical Framework

1.0 Introduction

Privatisation of state economic enterprises (SEEs)[1] became a major economic policy of many countries world-wide in the 1980s, and in some cases it amounted to a conscious attempt to roll back the frontiers of the state and return to the market. When economic growth and efficiency in the industrialised countries began to deteriorate in the 1970s, a shift towards the private sector started. The public enterprise sector and its efficiency and effectiveness became the core questions raised. The notion of privatisation has been looked upon as a panacea; first, to change the nature and the role of the state sector in developed and developing country economies, and second, it was hoped privatisation would bring improvement in the economic performance both at the micro and macroeconomic level.

The scope of privatisation has been broadened considerably as the process has advanced in the 1980s and 1990s. Privatisation has been implemented in several developed countries as well as in many developing countries. It has been considered as a remedy to severe macroeconomic problems and has been recommended and actively supported by international agencies such as the World Bank and the IMF.

Privatisation gained further political significance with the collapse of communism in Eastern Europe and hence the rejection of socialist values and practices

[1] In the literature, the terms state economic enterprises (SEEs), state-owned enterprises (SOEs) and public enterprises (PEs) or public economic enterprises (PEEs) are widely used. Sometimes a distinction is made between SOE and PEE which is applied to state ownership of natural monopolies such as the post office, railways and telecommunications. In this study, however, the terms 'SOEs' and 'SEEs' (in particular in the Turkish context because of the legal definition of a SEE) are used instead of PEs or PEEs and; 'SOEs' or 'SEEs' will be defined as "government owned and controlled entities that generate the bulk of their revenues from selling goods and services". For details see, Gillis (1980, p.252); Van de Walle (1989, p.601); (Galal *et al.*, 1994, p.17); (World Bank, 1995, p.6).

world-wide. In the 1990s, an attempt to create markets from the ashes of the former centrally planned economies (CPEs) of Eastern Europe started. This has involved the privatisation of whole economies or 'mass privatisation' (Ash *et al.*, 1994).

The public ownership of production and distribution is no longer generally favoured by economists and politicians. Today, the widespread belief is that the overall impact of SOEs on the economy has been negative rather than positive, especially in the developing countries. As inefficient monopolies, most SOEs have become a fiscal burden on the budget, hampering the development of the private sector, and their existence is seen to have resulted in the gradual deterioration of the general welfare of the economy.

However, the policy of privatisation has been justified, designed, and implemented in many different ways which have often led to a confusing and contradictory literature on privatisation. Students of privatisation, like the author of this research, have attempted to come to grips with its complexity utilising a number of theoretical explanations and analytical frameworks based upon both cross-national comparisons and numerous case studies.

Therefore, the main aim of this chapter is to create an analytical framework which will help us to organise conceptually many factors often cited in the literature that are supposed either to trigger or deter the policy of privatisation in the context of both developed and developing country cases. Before proceeding to the analysis of privatisation, the chapter briefly outlines the role of the state in economic development and in the emergence of SOEs. It is argued that poor performance of SOEs has been one of the main reasons for the move towards their privatisation. So, an evaluation of performance of SOEs around the world is presented. The rest of the chapter deals with the theoretical foundations of privatisation. Based on the empirical analysis of

successful privatisation examples of both developed (e.g. British and French) and developing (e.g. Mexican, Chilean and Argentinian) country cases, the chapter attempts to examine economic and political aspects of privatisation. A discussion about the origins, forms and objectives of privatisation is provided. Finally, the impact of privatisation is assessed within the context given above and some lessons are drawn from the experience of successful privatisation programmes, predominantly the case of the UK, in the conclusion. It is hoped that the lessons to be drawn from the analysis made in this chapter may be useful to other countries facing similar challenges in their efforts of privatising SOEs such as Turkey.

1.1 The role of the state in economic development

For decades, few questioned the central role of the state[2] in the economic development process which was based on theories advocating wide government intervention. The state was widely acknowledged to be one of the most important institutional devices for resource allocation along with the market (price mechanism), and the firm. Accordingly, states not only became involved in the industrial development process in many ways but the number of public sector enterprises also increased dramatically especially in developing countries. Bouin and Michalet (1991), for example, have identified three degrees of state involvement in developing countries and less developed countries[3] (LDCs): state dominated, state promoted and serving special interests. In the former, the state was seen as controlling 'commanding

[2] I intend to use the terms 'government' and 'state' as synonyms though it is necessary to maintain the distinction between them in other contexts.

[3] The use of the term 'Less Developed Countries' in this study refers to countries that are economically less well off than North America, Western Europe and Japan. Their living standards are poor compared to those of the developed nations. They include countries of Latin America, Africa, the Middle East and Asia (excluding Japan and the Newly Industrialized Countries such as South Korea, Taiwan, Singapore). Though there might be differences between the terms, 'developing countries' and 'less developed countries', I basically consider them as in the same category in order to avoid giving a much more complicated description.

heights' of the industry, and taking an active role in any sectors considered strategic for either political or economic reasons. The state became the legal owner of the main economic institutions which include basic industries such as iron and steel, the railway system, the textile industry, exploitation and processing of natural resources (Prager, 1992). Even though Bouin and Michalet refer to developing countries, their summary is also applicable to developed countries. The French government, for instance, used public enterprise to encourage its electronic (CGE- Compagnie Générale d'Electricité, Thompson) and high technology (Bull- computers, Aérospatiale- aeronautics) as well as other industries like automotive (Renault), pharmaceutical (Rhone-Poulenc), glass and building materials (Saint-Gobain), and aluminium (Péchiney) (Anastassopoulos *et al.*, 1987, p.13-15). The government believed that the private sector alone was unable to bring the nation to the forefront of world technological leadership in the intended sectors. For the policy makers of the time, certain microeconomic considerations such as the relation between costs and prices was non-existent or at best insignificant. The postwar years in Britain witnessed the nationalisation programme and the establishment of the welfare state in Britain. The government justified its nationalisation programme and the creation of the welfare state on the grounds of creating a stable economic infrastructure and reliable social provision rather than pursuing profit maximization (Clarke, 1993).

In state promoted economies, however, the private sector was assigned a much more crucial role in the economy. The state encouraged private sector enterprise by using nationalised industries to guide them instead of dominating the economy. Some governments assisted their own producers usually through the use of protective tariffs, exchange controls, tax incentives while others preferred to regulate labour market, train workforce and to open research centres to foster the development process.

Governments where the state was seen as serving special interests also used the state industry in selective ways to meet such ends. Some developing country governments established SEEs in order to reduce the concentration of private economic power in their economies. For instance, concentration of economic power was in the hands of a small number of families in countries such as Pakistan, Chile, or in the hands of ethnic minorities such as Chinese origin private business groups in Malaysia and Indonesia, and Indian and Pakistani oriented business groups in Uganda and Kenya (Austin *et al.*, 1986; Gillis, 1980).

In almost all developing countries, the public sector and nationalised industries in particular experienced a high rate of growth in the decades up to 1980. The reasons vary though the objective of achieving economic independence and freedom from foreign domination was expected to play a significant role in economic development (Gayle and Goodrich, 1990). For many African and Asian countries (e.g. Algeria, Ghana, India and Indonesia) independence in the 1950s and 1960s meant growth and development of the public sector enterprise. To achieve a high growth and fast development, governments put the policy of nationalisation and indigenisation of the core industries into practice in the 1950s and 1960s (Wilson III, 1990). In some other developing countries (e.g. most Latin American countries and Turkey), however, although independence came earlier, state involvement in the economy increased during the 1930s and 1940s as a consequence of the Depression and to fill the gap left by the private sector (Baer, 1994; Kjellström, 1990; Kepenek, 1990).

Import substitution was further encouraged in the 1960s and early 1970s, when developing countries dependent on primary commodity exports and manufactured inputs experienced a steady worsening of their terms of trade. Import substituting industrialisation (ISI) was identified as the solution, in which countries moved away

from dependence on world markets by expanding the public sector to produce both intermediate and capital goods and final consumer products. Much of this programme was actively supported by the World Bank, and many such programmes flourished in the 1970s (Babai, 1988). Gillis, for example, notes that:

> in particular in Africa and Latin America... the World Bank and the regional multilateral development banks have preferred to channel large proportions of their resources through SOEs rather than through ordinary government agencies or private enterprises in LDCs (1980, p.264-5).

Conditions were particularly favourable: the terms of trade moved temporarily in favour of the primary producers (led by oil in 1973), increasing export earnings; and the rise in oil prices and the recession in developed country economies released a considerable amount of 'petro-dollars' available for borrowing on easy terms (Killick, 1981; Decoodt, 1986). Thus the public sector in most developing countries expanded considerably, from 7 per cent of GDP in 1970 to 10 per cent in 1980 (Cook and Kirkpatrick, 1988), often with lax financial discipline. In developing countries, as a whole, public enterprise represented nearly 30 per cent of total investment (compared with 10 per cent in industrialised countries) and 11 per cent of value added (compared with 8 per cent for developed countries) (Adhikari and Kirkpatrick, 1990). The ratio of proportion of investment to output is much higher in developing countries, illustrating the inefficiency of the sector.

Public sector industries, initially acquired or developed, were traditionally concentrated in the public utilities and natural resource sectors, with an increasing stake in manufacturing as ISI policies were pursued in the 1960s onwards. The infant industry argument for protecting them was invoked to capture the effects of dynamic externalities. These reflected the objectives of nationalisation in these countries to counteract the imperfect capital markets. State owned and run public enterprises were seen as a means for generating surpluses to counteract imperfection of the markets. In

some other countries where socialism and interventionist economic management were chosen, state involvement was seen as appropriate responses to the need for development in view of market failures in capitalist economies. The form and structure of the public enterprise in developed countries was different from that in developing countries. As Clarke explains:

> In Britain and other West European countries the public sector was not the result of the oppressive intervention of a malign highly centralized state apparatus [like in some developing countries and in Eastern Europe]. On the contrary public intervention occurred in a widespread, decentralized way in recognition of the inadequacies of market provision (Clarke, 1993, p.207).

In some developed countries, the state enjoyed control of the enterprise though with only a minority stake, while in others, the state had a majority stake but chose not to exercise control. Some Western European governments had an indirect control but exercised control through financial holding companies. For example, in the former West Germany the federal government held at least a 25 per cent stake in 958 companies in the early 1980s while the Dutch state had direct stakes in more than 40 companies (Vickers and Wright, 1988). Similarly, France, Austria and Italy had a very large public sector in the post war period. Furthermore, the structure of the public sector is organised through huge industrial holding companies in some developed economies such as Italy's EFIM, ENI, IRI.

Following the policy outlined above, governments around the world started to set up SEEs, industrial organisations which are owned and run by the governments and located in the public sector. In particular in developing countries, this process lasted until the early 1980s. It was assumed that the growth of public enterprises was an important vehicle for fostering rapid economic progress and change which was needed at the time. This led SEEs to increase their relative positions in the economy

in the developed economies of the Western world as well as in the developing ones (Vernon, 1988, p.3).

Consequently, SEEs played a dominant role in most economies of both the developed and developing world, accounting for 10 per cent or more of their GDP (Vernon, 1988, p.3). The evidence shows that the number of SEEs increased from 180 in 1970 to over 1,155 in 1982 in Mexico, and these firms accounted for 10 per cent of Mexican GDP in 1980. Argentina had set up around 350 public enterprises by 1980. Brazil has set up over 450 SEEs in twenty years, reaching 600 SEEs when one adds in the existing ones. In Tanzania, the number of SEEs increased to 400 in 15 years which amounted to 15 per cent of the country's GDP (Austin *et al.*, 1986, p.51; Baer, 1994, p.511; Newell, 1994, p.4). Turkey seems to have followed the same trend by setting up around 400 SEEs up until 1980. Those SEEs have also displayed an upward trend in terms of GDP share within the economy. Turkish SEEs increased their GDP share from 7.8 per cent in 1977 to 12 per cent in 1980. In the manufacturing sector alone, SEEs accounted for 48 per cent of the total manufacturing value added in 1973. These SEEs were in general concentrated in industries like iron and steel, chemicals, petro-chemicals, paper, cement and machinery as well as being predominant in other sectors such as mining, transportation and banking (Karatas, 1986, p.135-6).

The picture of developed countries is similar to that of the developing ones. The number of SOEs increased in the postwar period in countries like France, Italy, Spain, Germany and Britain. In Britain, for example, public sector enterprises accounted for 10-11 per cent of GDP prior to 1979 and had £55 billion in turnover by employing around 1.8 million people in the sector (Nellis and Kikeri, 1989, p.659; Ernst & Young, 1994, p.xi). In France in 1983 SEEs accounted for 17 per cent of the

country's GDP and employed about 17 per cent of all salaried workers exclusive of agriculture (Austin *et al.*, 1986, p.52). Many other industrialised countries including Austria, Canada and Japan have or had at one time substantial public sectors.

In the 1950s, SEEs, notably in developing countries, were largely confined to the so-called 'natural monopoly'[4] sector, basic necessities, transportation and in some cases, banking. By the 1980s SEEs went beyond this pattern and they became common elements of the economies and they usually dominated in a variety of economic sectors covering manufacturing, construction, services, natural resources, and agriculture. Moreover, before the 1960s while most of these SEEs in the developing world were typically small scale undertakings, they became the largest, or among the largest firms in their respective countries. Some of them are still the largest enterprises in their respective fields of operation anywhere in the world. According to a survey, in the late 1970s, 34 SEEs from developing countries were among the 500 largest enterprises in the world. In terms of sales, 12 out of the largest 16 Korean firms are state-owned. Furthermore, Brazil's Petrobas (oil), Mexico's Pemex (oil), Argentina's YPF (oil), India's Hindustan Steel (iron and steel) and Turkey's Tüpras (crude-oil refining) were considered as some of the leading state-owned multinationals in the early 1980s (*Fortune*, 13.8.1979, p.193; *Fortune*, 30.7.1990, p.47; Anastassopoulos *et al.*, 1987, p.14-15).

The enterprises cited above reveal that SEEs are particularly dominant in the field of natural resources. Indeed, nowhere is the much-expanded role of SEEs more visible than in the natural resources industries which are very critical for some

[4] 'Natural monopolies' are characterised by declining costs with increasing scale of production, which enable a larger firm to enjoy lower production costs, and therefore undercut smaller competitors. Economies of scale which give rise to natural monopolies can be due to demand and cost/technological conditions, the small size of the market or large sunk costs. A typical example of a 'natural monopoly' is the electricity grid or railway network, where sunk costs and prime locations create barriers for new market entrants.

countries as in the case of Chile, Mexico, Venezuela and Zaire. Governments generally felt that non-renewable resources (e.g. oil, coal, copper etc.) should be exploited and processed by the state in order to maximise the benefits of such exploitation to the domestic economy. The strength of these large SEEs increased further to the extent that they could easily take over the market from the multinational corporations (MNCs), which operate within the same field and within the country. Thus, probably, by taking these reasons into account, Gillis (1980) argued that in many countries the impact of SEEs upon the course of development was more significant than that of the MNCs. As Gillis states,

> By whatever standard employed, SOEs now play a more critical role in the development process of a greater number of developing countries than do multinationals, and the relative importance of SOEs is likely to grow in the future (1980, p.249).

The argument about the role of the state in the economic development process could be extended, and it would also be possible to give a more detailed examination of the motives for establishing SEEs in developed and developing countries. But the common pattern which emerges from the analysis made here is that, in contrast to popular belief, political ideology has not been the main driving force behind the growth of the SEEs in market economies.[5] Countries of notably different ideological alignment such as India, Nigeria, Mexico, Brazil, South Korea, Turkey, the former West Germany, Canada, France and Britain, have all been major proponents of a large state-owned enterprise sector. The ideological grounding specifically referred to is the ideology of socialism wherein the state should own the means of production. But the analysis of the list of countries mentioned above makes it difficult to explain the existence of widespread SEEs simply on ideological grounds because none of the

[5] Under socialism or communism in the former CPEs of Eastern Europe or in other non-market economies such as China and Cuba, public ownership was considered as the only or dominant form of ownership. Consequently, public production and distribution were the only option available and real markets based upon the laws of demand and supply did not exist.

countries mentioned above can be called 'socialist' in orientation under any definition of the notion of socialism (Gillis, 1980; Austin *et al.*, 1986). Hence, it could be argued that in most cases, SEEs were set up to respond pragmatically to different types of economic needs and problems rather than purely responding to a coherent ideological framework.

1.2 Performance of State Economic Enterprises

The growing involvement of the state in the economic activities brought about a massive expansion of SEEs around the world which still control a significant share of production and investment in many developed and developing countries. However, the record of public enterprises in most cases showed that they failed to emerge as successful economic units. In contrast to the early hopes that SOEs would generate surpluses for investment finance elsewhere in the economy, they persistently generated deficits that have had to be financed from general revenues of the national treasury. In addition, the accumulation of losses and external debt obligations of SOEs crippled the development efforts in both developing and in most developed countries (Price, 1994b).

Many state enterprises also enjoyed monopoly privileges in their respective markets, privileges not nearly as readily available to private firms. Even these monopoly privileges extended well beyond those traditionally granted to state-owned producers of luxurious items like tobacco, beer, spirits; and to public utilities like power supply and distribution, and telecommunications. In some cases SOEs were in the position of suffering heavy operating losses which represented a chronic long standing condition. Therefore, virtually everywhere, the stereotypical image of state enterprises came to be one of inefficient, failed economic units. Of course, it is easy to criticise SEEs by simply looking at their set objectives and how many of these

objectives have been realised in the past 30 years or so. But it can be argued that government ownership in the form of owning and running state economic enterprises, has not worked out as expected since the 1940s.

In contrast to this judgment, it is not easy to demonstrate that all SOEs are completely inefficient either. The state-owned South Korean Pohang Steel Company (POSCO) and China Steel in Taiwan are among the highly efficient steel companies in the world (Aylen, 1987). Other examples of highly successful public enterprises include the Kenyan Tea Development Authority, the Ethiopian Telecommunications Authority (Jackson and Price, 1994). In the case of South Korea and Taiwan, however, Aylen (1987) argues that the successful results in performance of public enterprises including POSCO and China Steel have been achieved because of a 'high degree of political commitment' and it is an exceptional case; hence it may be difficult to duplicate this achievement in other developing countries.[6] In S. Korea a highly centralised leadership style, the government's use of the state-owned financial sector as an instrument of industrial policy, and a close relations between the executive and the large industrial groups such as POSCO, produced a dirigiste approach to industrial development. In Taiwan, by contrast, technocrats enjoyed greater influence. The management of most state enterprises was given clear social and financial objectives, a great deal of autonomy and day-to-day independence and SOEs were encouraged to follow the commercial principles of a family-owned firm. The management was also

[6] In fact, there is a vast literature on whether or not S. Korea and/or Taiwan could serve as a model for developing countries. On the one extreme, Korea and Taiwan are considered a model case for neoclassical economics and cultural modernisation theories. According to this 'developmental' approach, Korea and Taiwan have succeeded because 'they got the price right' (i.e. with proper economic policies and a continuation of reasonable international aid), and their example could be followed by any country that gets the price right, too. On the other extreme, the development of Korea and Taiwan is considered a prototype of state-led development. According to the 'statist' approach, development is led by the state, and depends on a very specific political and socio-cultural environment; therefore a given model cannot be substantially copied easily, if at all, by other countries. For a detailed discussion on the issue, see Haggard (1990), Corbo *et al* (1985).

technocratic in approach, militaristic in achieving targets and, in the case of steel industry, disciplined by import competition from abroad (Haggard, 1990). Furthermore, support for the state's control of the commanding heights of the economy such as steel, petro-chemicals and heavy machinery projects, has been given for political and military reasons; the relations between Taiwan and mainland China, and South Korea's tense relations with its neighbour, North Korea, to some extent, made the success of certain sectors imperative. The state in Korea and Taiwan, therefore, undertook production directly or provided its strong support for expansion and the success of these large projects because of strategic concerns such as external threats, and/or the fear of shortages in supply of these products in the face of rapidly growing domestic consumption.

In developed countries, the financial position of SOEs was very weak in the 1980s too. Despite the successful public enterprise sector in the former West Germany and some successful enterprises (e.g. British Aerospace and Amersham International) in Britain and elsewhere, the image of SOEs in the 1980s was far from satisfactory. In Italy, IRI was losing around 5 million lire for every one of its half a million employees in the mid-1980s. In France, despite improvements in the overall performance of public sector enterprises after 1982, the French state was still pouring huge amounts of money into its troubled nationalised firms such as Renault and Air France. Before privatisation in Britain, no automatic bankruptcy or soft budget mechanism for public enterprises meant that enterprises such the British Steel Corporation and the National Coal Board could accumulate large losses which were subsidised from the government budget (Vickers and Wright, 1988).

The observations above in developed and developing countries brought about some questions. For example, why are some SOEs more successful than the rest? Is

the good performance of the successful SOEs related to the appropriate system of incentives or the environment in which they are operating, or anything else? Answering these questions requires further and detailed analysis of the SOEs.

However, the vast majority of studies on the public enterprise sector either concluded that SEEs were inefficient and thus they failed to match expectations, or they found little evidence for SEEs as satisfactory units. Nellis and Kikeri (1989, p.660) generalise this belief saying that "too many public enterprises cost rather than make money; and too many operate at low levels of efficiency". Some of these studies are even more pessimistic in relation to the SEEs. Alexander citing from a World Bank survey concludes that:

> public enterprises have contributed little to national savings and are a major source of savings-investment gaps, which in turn closely correlated with current account imbalances... (cited in Heath, 1990, p.4).

and he also suggests that:

> Most were in very poor condition and needed specific action in the short term to curb sizeable financial drains on the budget (cited in Heath, 1990, p.198).

Supporting this evidence, Adhikari and Kirkpatrick reached a similar conclusion:

> the weight of evidence surveyed on financial performance seems to support the conclusion that public enterprise performance has been unsatisfactory. In most cases these enterprises failed to generate sufficient revenue to cover their recurrent costs... and they have contributed significantly to the macro-economic problems, particularly external debt, experienced in many developing countries (1990, p.41).

They also found that, with a number of important exceptions, productivity levels were lower in the public sector than in the private sector but productivity growth was often higher in the public sector. The efforts of cost reducing, modernisation, and structural adjustments to meet market needs, were also found to be lower in public sector enterprises than in their private counterparts. The World Bank, one of the

major supporters and financiers of SEEs prior to the 1980s, arrived at a similar conclusion. A World Bank report summarises the case of SEEs as follows:

> Some state-owned enterprises have been able to operate as successful commercial ventures without burdening public finances. In most countries, however, many have drained budgetary resources, contributed to overall public sector deficits, weakened fiscal management, and made negative contributions to value added (cited in Adhikari and Kirkpatrick, 1990, p.26).

In relation to profitability, Short's survey found that although deficits of SEEs in developed countries were smaller than those of SEEs in developing countries, net losses characterised parastatals world-wide (in Prager, 1992, p.305).

It is suggested that profitability may not be a reliable measure of the efficiency dimensions of public ownership. Though consistent losses may point to inefficient operations, reasons unrelated to efficiency such as low prices imposed by government directives may account for the poor financial picture. Similarly, if efficient firms are profitable, inefficient firms can be too, by providing them with the right environment. Nevertheless, the uncertain relationship between profitability and efficiency suggests that a more direct approach to evaluating SEE efficiency would prove more suitable. For example, as Millward explains:

> There is no evidence of a statistically satisfactory kind to suggest that public enterprises in LDCs have a lower level of technical efficiency than private firms operating at the same scale of operation. On a less formal level the tendency in Turkey, Indonesia and Tanzania seems to be nevertheless pointing in that direction (1988, p.157).

All the evidence shows that there is a negative picture of SEEs around the world, apart from, perhaps, a number of successful examples. But, how do we explain this failure? Or, why do we have a negative picture of SEEs in developed or developing countries? One author summarised the common weaknesses of SEEs in the following terms:

> unclear, multiple or contradictory objectives, bureaucratic meddling, overly centralised decision making, inadequate capitalization, managerial ineptitude, excessive personnel costs and high labor turnover (Shirley, 1983 cited in Van de Walle, 1989, p.603).

Furthermore, according to *the World Bank Development Report 1988*, which more specifically refers to the failure of SEE management called this a "failure of government rather than the failure of public enterprise itself" (Garner, 1988, p.26). The reasons for this failure are stated in the report as follows:

> Several constraints, however, limited the ability of SOE managers to increase operating efficiency. Among them are the inability to reduce labor to cut costs, lack of control over compensation decisions, inability to close certain product lines, inflexibility in procurement decisions, and constraints on the choice of product mix, markets, and suppliers (cited in Prager, 1992, p.318).

It is argued that nationalisation programmes carried out in developed countries including Britain, failed to establish an adequate framework that would ensure efficiency. The incentives for serving customer interests and controlling costs were usually non-existent or at best weak. Similar to those in developing countries, management was given ill defined objectives and these frequently conflicted with political objectives. Lack of clear objectives, ambiguous incentives, poor financial information, and inadequate cost control systems all coupled with political interference contributed to the inefficiency of the public sector.

In short, governments undertook to produce a range of goods and services rather than rely on the market solely for a variety of reasons. Some SEEs were justified in principle on efficiency grounds, because the private sector was unlikely to produce or market goods or services at economically appropriate price levels. Others came about through fiscal or financial purposes, while political expediency or necessity still accounted for some others. The underlying rationale for this was the conviction that the state-owned and run enterprise could achieve goals that the private sector could not or would not accomplish.

However, in the 1980s, what happened was that governments' patience with SEEs came to an end when SEEs did not solve the problems they were supposed to take care of; rather they often became problems themselves. Besides poor performance of SEEs, two very important developments occurred in the early 1980s: firstly, economic conditions worsened and fiscal crises became endemic, in particular, in the developing world; secondly and more importantly, the ideological climate changed and turned against the public sector in favour of the private sector. In this regard, the obvious solution for the problems of SEEs, seemed to be privatisation. Some proponents of privatisation see it as an end or goal in itself. They argue that privatisation is the only solution to SEE problems assuming that the primary function of any firm is to operate as efficiently as possible. In particular, the vigorous efforts by the Thatcher government and Reagan's administration to redraw the boundary between the public and private sectors found support around the world.

1.3 The new model

The bubble of public sector expansion was bound to come to an end in an environment where governments of developed and developing countries were having a hard time solving economic problems, mainly 'stagflation'[7] and 'taxflation'[8] and other problems derived from those in the late 1970s. The crisis came almost universally in the early 1980s. The terms of trade suddenly worsened, exacerbated for non-oil exporting countries by the second oil price shock in 1978, causing drastic deterioration

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[7] Stagflation can be described as an unhappy combination of high price inflation, high unemployment and low economic growth. It was regarded as an indication of the failure of Keynesian-style demand management and led to call for incomes policies, including a tax-based incomes policy (Helliwell, 1988; *Macmillan Dictionary of Modern Economics* edited by D.W. Pearce, London: Macmillan, 1992).

[8] It is an explanation of inflation in terms of the effects of government taxation and social security charges on the labour market. It is argued that a widening gap between pre-tax and post-tax employment incomes (i.e. an increase in average tax rates) encourages trade unions to ask for higher money wages which in turn leads to general inflation. Also known as 'taxflation'. See *Dictionary of Economics* edited by D. Rutherford, London: Routledge, 1992, p.488.

in the balance of payments. Demand was slow to respond since consumers were protected by artificially low exchange rates, and economies of most developing countries experienced shortages in vital imports rather than price rises. The debt crisis of Latin American countries due to the increase in real interest rates, especially in Mexico and Brazil, made external borrowing in the international banking system and rescheduling outstanding debts extremely difficult (Killick, 1981). So, many governments from middle income Latin American to poor countries of less developed countries found themselves in severe financial difficulties. Moreover, all these external problems contributed to rocketing inflation and large public sector debts.

Developed country economies also came under the increasing pressure of the second oil price shock. Accompanied with rising levels of unemployment and inflation, developed countries with their Keynesian economic policies were unable to produce solutions for the existing economic and social problems. There was a crisis of confidence in the foundation of Keynesian policies. Since public sector expenditure and the welfare state were seen to be part of the problem, not the solution, governments started to abandon traditional Keynesian economic policies and to look for new policy alternatives.

In that period, Milton Friedman who criticised the interventionist characteristics of Keynesianism and advocated setting up a free market ideology, and F. A. Hayek who presented the market as the most efficient communications system in complex societies, became leading figures among economists. Friedman presented his theoretical and philosophical principles (regarded as liberal capitalism or the philosophy of the Chicago School) in his works like *Capitalism and Freedom* and *Free to Choose*. Friedman accepts that governments may well have the best intentions when intervening in the market but, he argues, they invariably make matters worse.

Moreover, the adverse consequences of government policies are often unexpected and unintended by products of attempts to improve upon market performance. Very frequently governments fail to look beyond the immediate outcomes of their economic policies to the adverse long-run effects. Therefore, he strongly suggests that:

> ... the scope of government must be limited. Its major function must be to protect our freedom both from the enemies outside our gates and from our fellow-citizens: to preserve law and order, to enforce private contracts, to foster competitive markets. Beyond this major function, government may enable us at times to accomplish jointly what we would find it more difficult or expensive to accomplish severally (Friedman, 1982, p.2).

This is very close to the argument of Adam Smith supporting a restricted role for the government with the recognition that state interference is necessary but must be limited. To govern better, one had to govern less. Friedman's theory and principles of conduct were discussed by academics and some of these policies had a chance to be implemented after the election victories of Margaret Thatcher and Ronald Reagan in the UK and the US respectively.

Reagan's recovery programme, or as also called '*Reaganomics*',[9] was based on his long-standing belief that "the most important cause of our economic problems has been the government itself" (Niskanen, 1988, p.4). Therefore, Reagan put forward his principal objective, "the size and role of the government should be reduced". He argued "only by reducing the growth of the government can we increase the growth of the economy" (Niskanen, 1988, p.4). In Britain, the Conservative Party leader, Thatcher, announced her commitment to a 'free market economy'. In the foreword of the 1979 election manifesto, Mrs. Thatcher declared that:

> No one who has lived in this country during the last five years can fail to be aware of how the balance of our society has been increasingly tilted in favour of the State at the expense of individual freedom (cited in Roper and Snowdon, 1987, p.1).

[9] The term basically refers to the economic policy implemented in the course of the Reagan administration.

It was suggested that the process of 'rolling back the frontiers of the state' was put into practice as the ideology of the new Conservative government. Like Reaganomics, *Thatcherism*[10] typically contained similar economic norms and ideas. Coutts *et al* (1981) note the following pursued economic policy strategies:

> ... The Thatcher Government has embraced a doctrinaire monetarist strategy for controlling inflation and a laissez-faire approach to the supply side of the economy without attempting to moderate the social impact of these policies (cited in Roper and Snowdon, 1987, p.7).

The main objective of Thatcherism was to roll back the state by reducing the level and range of government interventions in the economy. It is argued that this could be achieved by restoring sound money, by reducing public expenditure, and by removing all obstacles to the working of free markets in order to encourage private enterprise. Besides, freeing the labour market, and restoring the authority of government can be counted as some other aims of Thatcherism (Gamble, 1989; Jessop *et al.*, 1988). The economic recovery and especially the efforts to restore the authority of the state by Thatcher leadership have been described as promoting "the free economy and the strong state". The New Right which provides ideological underpinning for the notion of Thatcherism, sought to create a free economy and a strong state (Gamble, 1989).

The New Right revitalised the role of economics and the ideas about individualism and markets. The supporters of this ideology share a faith in the minimal state of classical liberalism where one has the protective and productive state playing a minor but necessarily sufficient role. They argue that the welfare state destroyed incentives. High levels and rates of taxation, which were then necessary to finance growing public spending, created disincentive effects which had considerable

[10] In this study I will use the definition of Jessop *et al.* for the term of 'Thatcherism'. According to this approach, *Thatcherism* is regarded as the distinctive set of policies pursued by the Conservative Party under the Thatcher leadership (Jessop *et al.*, 1988, p.7).

impact for the supply side of the economy. They publicised a new slogan which stated that 'markets work, governments do not'. They argue that markets will work if the right environment is provided. The recipe for the creation of right environment is to get competition in and government out (Wynarczyk, 1987). The New Right promoted its argument so well that, in particular, Friedman and Hayek became very influential on Thatcherism. For example, one of Thatcher's advisers wrote this in *The Guardian*:

> Ideas from Hayek and Friedman .... were assimilated precisely because experience had already created a place for them by convincing people that neo-Keynesian economics, trade-union hegemony and the permissive society had failed (cited in Levitas, 1986, p.15).

Hayek and his fellow economists argued that there was no middle way between capitalism and socialism. Hayek explained that under socialism, there cannot be a possibility of rational economic calculation because private ownership as a means of production has been abolished and the market suspended. Therefore, any socialist economy would be likely to be inefficient because the modern economic order was too complex to be centrally planned even in the age of computers which would allow planners to store the necessary data. He put the greatest emphasis in his analysis on how the economy had been politicised; more and more economic decisions had been transferred to the public sphere or interfered with by public agencies (Gamble, 1986). Public expenditure and taxation had grown enormously by creating an army of public agencies, and continued to increase government spending. Once trade union power became strong and mass political pressure groups took their position within a political structure, they started to pressure and influence interventionist governments in their decision making (Butler, 1983). Hayek and other New Right economists suggested curbing trade union power by removing trade union legal immunities, and outlawing picketing and the closed shop as they saw trade unions as a major source of slow growth whenever they interfered with management's right to manage.

Attempts to 'roll back the frontiers of the state' first started in the UK and the US and then they were pursued by governments in several other countries, sometimes leading to results different from what was expected and which varied from one country to another. Reducing public sector deficits in order to control the money supply, tax cuts to provide private sector more room to grow in the context of setting a 'free market' were some of the (sometimes contradictory) policy prescriptions. It was argued that most of the economic problems were caused by the size and role of the government. Thus, the size and role of the government should be reduced.

The emergence of the new model, which focuses upon privatisation, and its elements such as objectives, forms, political and economic aspects, impact, successes and failures, is the subject matter of the rest of this chapter. Privatisation became one of the major themes of the Thatcher economic policy in the 1980s and was the central component of economic reform attempts in other countries. Thatcherism and its most distinctive element, privatisation, found supporters in other developed countries such as Japan, Germany, Canada and France. Perhaps, more interestingly, developing countries tried to follow and to implement the same type of policies pursued by Thatcher in Britain in the 1980s. Although some governments in the developing world sought to follow independently the examples set by the developed countries, most developing countries were advised and supported to implement similar policies, namely public sector reforms, privatisation and liberalisation through the conditions attached to structural and sectoral adjustment loans made available by the World Bank and the IMF.

Turkey was one of the first countries which took this path with the announcement of the 24 January 1980 stabilisation programme which will be discussed in chapter three. This austerity package, aimed at massive restructuring of

the economy, emphasised liberal economy and export-oriented growth strategies and privatisation of SEEs was an important part of it. The election victory of Özal's centre-right Motherland Party (MP)[11] government in 1983, gave a momentum to the implementation of the new economic policies which were very similar to those pursued by Thatcher and Reagan in the 1980s, albeit leading to results different from Thatcher's economic policy.

1.4 Privatisation: Its Various Definitions and Forms

The literature on privatisation is often confusing and sometimes contradictory. Many authors on the subject perceive and define the word 'privatisation' differently. The concept of privatisation is also a very complex one, due to its economic, political and social aspects. In particular, politics plays the most important role, first it decides whether or not to privatise and, second how to privatise. Therefore, since privatisation is a such complex subject, this section seeks to explore the different meanings of privatisation as practised around the world.

Several governments throughout the world, from the richest to the poorest, have embraced privatisation in order to maximise consumer choice, promote competition and improve quality and efficiency of the goods and services provided by the state-owned enterprises. Many of these governments have been slowly turning SOEs over to the private sector. In that sense, privatisation can be broadly defined as a policy which embraces a "wide range of policies designed to reduce the scope, limit the functions and generally weaken the influence of the public sector" (Vickers and Wright, 1988, p.3). In some cases, governments choose to retain ownership but opt to transfer managerial know-how to the private sector. Ramamurti (1992) argues that privatisation "refers to the sale of all or part of a government's equity in state-owned

[11] It is better known by its acronym, ANAP.

enterprises to the private sector" (p.225). Privatisation as defined by Hanke (1987) is a transfer of assets and service functions from public to private hands. He emphasises activities ranging from selling SOEs to contracting out public services with private contractors. In relation to the UK case, Ramanadham (1989) argues that the idea of privatisation most prominently suggests "denationalisation (in the sense of transferring the ownership of a public enterprise to private hands). Another idea in vogue is liberalisation and deregulation, which unleash forces of competition" (p.4). Privatisation is also seen as a range of different policy initiatives intended to change the balance between the public and private sector and the services they provide. Cook and Kirkpatrick (1988), for example, distinguish three main approaches to privatisation: a change in the ownership of the enterprise, liberalisation or deregulation and a transfer of goods and services from the public to private sector while government retains ultimate responsibility for supplying the services. Others perceive privatisation from a broader perspective and define the concept "as part of a much wider policy response in the restructuring of the relationship between state, market and society which has characterised the politics of West European states since the early 1980s" (Wright, 1994, p.5).

Whatever the definition, privatisation involves a shift from public to private interest. In general, a widely accepted definition of privatisation implies a partial or total transfer of a state-owned enterprise to private ownership and control. Hence, this study commonly views privatisation as a process of transfer of assets from the public sector to the private sector.

Privatisation is a measure that has been implemented by several governments world-wide in both developed and developing countries. There are different forms of privatisation used in different countries. For example, Young (1986) identifies seven

different forms of privatisation used in Britain in the 1980s. Each form of privatisation has its pros and cons as discussed below. The following forms of privatisation have been used in Britain and elsewhere in the process of privatising public enterprises.[12]

• ***Direct sale to general investors***: This form of privatisation involves a total sale of all or part of the state's share of a company to private investors. There is an actual change of ownership of an enterprise from the public to private sector.[13] The sale of Rover to BAe and Jaguar to Ford in the UK, CNTV (telecom) to GTE (an American phone operator) in Venezuela, the sale of 25 per cent of Qantas to British Airways, or the sale of SEAT to Volkswagen in Spain are some of the examples of privatisation of this type. This form does not require share offerings or the services of financial intermediaries such as brokers, underwriters or other agents and it can be implemented in two common ways: through competitive bidding (direct sale by tender) and to a predetermined selected buyer.

Direct sale through competitive bidding is preferable as it allows the state to compare offers by competing bidders and select the buyer offering not only the highest purchase price but also the greatest compliance with various government requirements and privatisation objectives. Another positive feature of the tendering process is its high degree of transparency compared to sales to selected buyers. The slowness of public tenders and the significant administrative costs of the tender process are the main disadvantages of the public tenders.

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[12] For details of privatisation methods, see Young (1986); Vuylsteke (1988); Kikeri *et al.* (1994); Ernst & Young (1994); UNCTAD (1995).

[13] The sale of subsidiaries (also called trade sales) which were retained by the parent industry can be included to this category. The sale of British Rail's hotels and Sealink, Post Office's Girobank, are some of the subsidiaries privatised in the UK (Ernst & Young, 1994, p.32).

Direct sales to selected buyers have the disadvantage of a low degree of competition and transparency. They should therefore be used only where there is a very limited number of potential investors possessing sufficient financial and managerial resources. Under these circumstances there is little scope for improving the terms of the sale by going to a public tender.

The direct sale method is widely used in developing countries and countries in transition to privatise mostly small and medium size firms. This is largely due to the fact that in these countries capital markets are either underdeveloped or non-existent, thus preventing public share offerings. In addition, direct sales are relatively simple in terms of preparation and execution.

An important issue regarding direct sales is the involvement of foreign investors either as competitive bidders in a process of public tender, or as selected buyers who may have been chosen because they possess the necessary capital, technology and know-how. The participation of foreign buyers may be a sensitive issue and may bring about some serious economic, social and political problems in some developing countries, in particular if transparency is low. In the case of privatising strategic industries such as oil, mining, transportation and telecommunications, government officials may be allegedly accused of selling the national interest to foreign investors. In Turkey, for example, the sale of five cement plants and an airline catering company to foreign investors met with stiff opposition and the sales were annulled by the court. In other developing countries, the results have been even more serious resulting in political demonstrations, sabotage and destruction as in the case of the copper mines in Chile and the oil industry in Algeria. Thus, any government which attempt to use this method should make sure that public confidence in the integrity of the procedures is maintained.

• ***Public share offerings on stock exchange:*** This method is usually used for profitable, large-scale public enterprises. Often the share offer is used as an opportunity to raise additional capital, as well as to transfer the ownership of the enterprise. It can also serve the objective of promoting transparency and widespread share ownership through the allocation of a proportion of shares to small investors. This method seems to be much more suitable for privatisation in developed industrialised countries where capital markets are well established and developed rather than developing or in LDCs where capital markets are weak or non-existent. Furthermore, equity could be easily sold to the public because of the purchasing power of the people whilst in most developing countries this may not be an option.

During the 1980s, the Thatcher government in Britain successfully carried out this form of privatisation; for example, the sale of British Telecom (BT), British Airways (BA), British Gas (BG), British Aerospace (BAe), British Petroleum (BP) as well as regional electricity companies and water industry. Other best-known examples of public offering are the Japan's Nippon Telegraph and Telephone (NTT) and Japan Air Lines; Société Générale (banking), Péchiney (aluminium), Rhone-Poulenc (pharmaceuticals) and Elf-Aquitaine (oil) in France; YPF (oil) in Argentina; Telefonos de Mexico (Telmex) (*The Economist*, 21.8.1993; *Euromoney*, February 1996).

With this privatisation method, shares are offered to the general public, generally at a fixed price. In a public issue, shares are typically sold under a formal contract overseen by the state regulatory authorities. Transparency is generally greater than for direct sales of SEEs because of the advertising and disclosure requirements associated with a public share offer. Public share offerings are especially suitable where the size of the sale justifies the additional cost involved and where transparency is a particularly important consideration.

Variations on this form of divestiture relate to the fixing of the share price, which can range from a fixed price offer to a tender offer, or a combination of both as in the UK, which pioneered an international global tender and domestic pricing arrangement for the sale of shares of BT. Another variation concerns targeted buyers, which includes a variety of incentive schemes designed for small investors. For example, in France and the UK, different types of bonus schemes for long-term retention of shares by small portfolios have been introduced.

There are also variations concerning the treatment of small investors in relation to institutional or "core" investors. In France and the UK, for example, some public offerings use the "claw back" method which allows the number of shares allocated to small investors when there is high demand on their part to be increased at the expense of institutional investors. In France, subscriptions of small investors receive priority treatment and a 20 per cent discount is granted for shares held for more than four years.

"Core" investors are often seen as a requirement for good corporate governance of the privatised firms. The practice in France is to sell blocks of shares, representing 20-30 per cent of the total, to several "core" institutional investors, selected on the basis of open public tenders.

• ***Liberalisation and deregulation:*** The liberalisation or deregulation of entry into activities previously restricted to public sector enterprises is another form of privatisation (Cook and Kirkpatrick, 1988; Clarke, 1993). This form removes all or some restrictions to enter a particular market in order to increase competition, hence providing more choices to the consumer. The advantages of this form of privatisation are that it increases competition in the marketplace and increases choices to the consumer. This form has been widely used in many developing countries as well as in

developed countries in various sectors of the economies. In Britain, the bus service and the parcel delivery service were deregulated to expose these sectors to competition.

• ***Contracting out:*** It is the simplest form of privatisation. This type of privatisation is widely used. It is the principal form of privatisation in the US. Gayle and Goodrich note that "80 per cent of US cities and counties presently use or plan to use private companies to produce such services as building, vehicle, and street maintenance" (1990, p.3). In Britain, services that were once performed in the NHS, in civil service and in local government by direct labour are now provided by the private sector companies. It is claimed that the extent of contracting out in Britain is wider than anywhere else in Europe (Wright, 1994). Contracting out is also commonly used in the developing countries where the private sector is involved in the provision of certain goods and services but the government remains in charge of all major activities.

The principal advantage of this form of privatisation is that it allows the private firms to compete in the marketplace. Contracting out creates jobs in the private sector. It seems that contracting out works better in advanced economies. In developing countries, one of the disadvantages of contracting out is that government officials and ruling elites tend to give the contracts to their business associates, friends and family members which, in some cases, leads to corruption charges. Therefore, this form of privatisation might have negative political and economic consequences, if the contractors are unable to deliver the desired goods and services to the consumers.

• ***Management and employee buy-outs (MEBOs):*** This form of privatisation is also called 'internal privatisation'. While in most cases MEBOs involve the sale of an entire state enterprise, there are also cases where a state enterprise is broken up into

divisions or sub-units (National Bus) and then it is sold. In the former, for instance, the buy-out of the National Freight Consortium (NFC) created a highly successful business in the UK. It is said that MEBOs offer many potential advantages. The primary reason for MEBOs is that, by giving management and employees a personal stake in the company, they are motivated to find ways to cut costs, improve productivity and generally operate more efficiently (Ernst & Young, 1994, p.28). Moreover, such methods can also help to win the support of reluctant employees and managers for privatisation. However, the cons of MEBOs is that the potential success of MEBOs may be undermined if management and staff have relatively little experience of commercial market practices, in particular in unstable macroeconomic conditions.

• ***Mass privatisation:*** This form of privatisation is also called 'voucher or coupon' privatisation and it has been widely used in the countries in transition (e.g. Russia, the Czech Republic, Slovakia and Poland) but is not commonly used in the developing countries. The mass privatisation technique is based on the population-wide distribution of vouchers, certificates free of charge or for a nominal fee to all adult citizens. The rationale behind this method of privatisation is the fact that, in the former CPEs of Eastern Europe, ownership of the assets of the means of production was considered to belong to the people as a whole, represented by the State. Thus, it would not be possible for these countries to make a rapid ownership transformation by using standard forms of privatisation as employed in the market economies. The main advantage of mass privatisation is the rapid ownership change from the state to individual shareholders. Mass privatisation differs from one country to another, and it has been criticised for several reasons. The rapid process of ownership change, for instance, has been abused in several ways in some countries, such as Russia, where

some wealthy or influential individuals were the principal beneficiaries of the scheme (OECD, 1993a; Ash *et al.*, 1994).

• ***Other forms of privatisation:*** In the literature, other types of privatisations are also mentioned. These vary from selling council houses in Britain to reducing subsidies and increasing charges for welfare services. In some developing countries, governments may prefer to liquidate some of their SOEs (Mexico and Colombia) and sell their assets because the performance of the enterprises so poor and their future prospect is bleak thus no buyer can be found for them, whilst other governments opt for joint ventures or prefer to encourage the private sector to invest in certain projects. The former partnership often involves a foreign partner who may provide capital and know-how. The government retains a share in the public enterprise but the partners combine their resources and expertise to accomplish a specific objective. In the latter case, governments usually grant concessions which transfer its operating and development rights to a private sector firm or a consortium. One typical form of concessions is the build-operate-transfer (BOT) scheme for the private development of infrastructure projects (e.g. dams, motorways, airports etc.) which is used in several countries including Argentina, Mexico, Malaysia and Turkey.

1.5 Objectives of Privatisation

Privatisation objectives are broadly similar across countries. They centre around the benefits to be gained from rebalancing the roles of the private and public sectors to enhance the productive power of the economy. However, the specific reasons behind privatisation at the national level are varied and inter-linked. The objectives can be political, economic, fiscal, social, or in most cases, a combination of several of them.

As reflected in the definition of the term in the existing literature, the explanation of the reasons for privatisation has become a more complex issue than just 'state versus market' argument. Different interests defend privatisation for different reasons. Moreover, motives for privatisation have changed over time as in the case of the UK and Turkey.

As experience shows, privatisation objectives can sometimes conflict, or appear to conflict, thus complicating the implementation of a privatisation programme. For instance, the sale of public monopoly without provision for price regulation could achieve a higher sale price. This policy could further help the objective of raising revenue to reduce public sector debt, but would conflict with the objective of creating a competitive industry and enhancing economic efficiency. Similarly, the objective of promoting wide share ownership may conflict with the objective of fostering good corporate governance. Though a well planned privatisation programme and careful prioritisation of the various objectives to be achieved may help to resolve most of the potential conflict in privatisation process, it may still be unavoidable for the governments to trade off some of the objectives of privatisation. The lessons learned from successful and unsuccessful privatisation experiences in other countries can also be a rich source of ideas in this regard.

The following classification of the objectives of privatisation is offered by Vickers and Yarrow (1988, p.157):[14]

- reducing government involvement in industry;
- improving efficiency in the industries privatised;

[14] While some authors provide very long lists of reasons for privatisation, some others indicate much shorter and briefer objectives. In the case of the UK privatisation programme, for example, Veljanovski (1987) and Letwin (1988) note eight and nine objectives of privatisation respectively, whilst Grimstone (1990) gives six; and other authors follow them with shorter lists which contain similar explanations (Hatch, 1988; Heald and Steel, 1982; Mitchell, 1990; Ramanadham, 1988).

- reducing the public sector borrowing requirement (PSBR);[15]
- easing problems of public sector pay determination by weakening the public sector unions;
- widening share ownership;
- encouraging employee share ownership; and
- gaining political advantage.

These objectives mainly apply to the UK, which is an example of a wholesale privatisation implementation, and to most developed countries. Evidence from other countries, especially developing countries and LDCs, has revealed that other objectives have also been attached to the privatisation programmes besides the ones stated above (Cook and Kirkpatrick, 1988; Bienen and Waterbury, 1989; Van de Walle, 1989; Cook and Minogue, 1990; Zank, 1991; Ramamurti, 1992). Most governments in the developing world, usually under the pressure exerted by the international financial institutions, have initiated privatisation in order to stabilise the macroeconomic situation as well as to attract new investment, especially much needed foreign investment (e.g. in Mexico and Argentina). Developing or strengthening capital markets (e.g. in Turkey and France respectively) was another objective of privatisation for some governments (Önis, 1991b; Durand, 1996). Generating immediate cash for foreign exchange and settling foreign debt is another reason for privatisation in the developing world (Zank, 1991).

These are the main objectives of privatisation which are frequently cited in the literature. We will refer back to some of these objectives later on as we go along. However, one of the main objectives of privatisation is to promote competition and

[15] The PSBR is the total borrowing at the end of the fiscal year needed to cover the central government's own budget deficit and the financial deficits of local authorities and public corporations, plus government lending to the private sector.

enhance efficiency, at least in the UK. John Moore[16] specifies the British Government's hopes for gains from privatisation as follows: "Our main objective is to promote competition and improve efficiency" (1986, p.93). He regarded the objectives such as reducing the size of the public sector or funding the PSBR as secondary.

In the literature, a large number of arguments are put forward that privatisation will improve the efficiency and financial performance of public enterprises (Moore, 1986; Vickers and Yarrow, 1988; Grimstone, 1990). Beesley and Littlechild[17] (1994), for example, set out this point very clearly. They consider that privately owned firms will have a greater incentive to produce goods and services in the quantity and variety which consumers prefer. Virtually, then, their argument is that privatisation will promote greater efficiency. They consider that especially privatisation will facilitate the promotion of competition, which they regard as the most important mechanism for meeting their criterion of maximising consumer benefits. It is this aspect of privatisation that we now turn to.

1.6 Economic Aspects of Privatisation

Arguments about privatisation can be judged on ideological grounds alone, as a preference for private rather than public ownership as we discuss in the following section. However, most economists have also tried to provide reasons for the superiority of resource allocations based on market mechanisms rather than the administrative fiat of bureaucracy. They have agreed that privatisation, if well carried out, leads to competition and achieves much greater efficiency and produces a much

[16] John Moore MP was the Financial Secretary to the Treasury in 1983, and according to Grimstone (1990), Moore was the government minister who gave the privatisation programme in the UK an intellectual coherence that it had previously lacked.

[17] Both authors were advisors to the British government on its privatisation programme.

better quality of goods and services than the SOEs. Furthermore, they have pointed out that the competitive forces which can be found in markets rather than bureaucracy are more likely to produce better allocation of resources. Proponents of privatisation claim that it provides greater incentives for cost minimisation, encourages more effective managerial performance, stimulates greater efforts of employees.

The aim of this section, therefore, is to examine the claim that privatisation promotes competition in the marketplace and improves efficiency and quality at lower costs to the maximisation of consumer satisfaction. This is the standard economic approach to privatisation in relation to competition, efficiency, or at least to the efficiency of privatisation.

The core of the analysis of privatisation is the concept of efficiency. The economists who use the term 'efficiency' refer to "Pareto efficiency" which means that it is not possible to re-arrange the companies, the flows, the production decisions, the consumption decisions or anything else in the economy, and make someone better off without making someone else worse off. If the conditions of perfect competition are assumed without any externalities, competitively determined prices will eventually settle down to marginal costs. The existence of any externalities will, however, cause private and social costs to diverge. If there is imperfect competition or any other forms of market failure then the basic propositions of Pareto efficiency will not be achieved (Bös, 1988; Jackson and Price, 1994).

Efficiency can be analysed in at least two principal dimensions: Firstly, there is *allocative efficiency*, which requires that companies produce the level, mix and quality of output at a price where it is not possible to re-arrange the outputs of an economy and make one consumer better off without making another consumer worse off. It is assumed that all possible gains from trade have been exhausted. Secondly, there is

technological or *productive efficiency*, which requires that the companies produce the output demanded by consumers at the lowest possible cost subject to the technical constraints of production. Technical efficiency assumes that it is not possible to re-arrange the production inputs and obtain more output of a given good or service without reducing the output of another good or service. This means that the input mix is efficient.

It is of considerable importance that the type of efficiency is distinguished because the popular literature on privatisation focuses on technical efficiency and tends to ignore allocative efficiency. As a result, policies are directed at cost-cutting while policies concerning pricing reflecting costs more closely are often ignored (Bös, 1991).

Privatisation can be justified on the grounds that it increases the productive (technological) efficiency of operations in the privatised companies. Many empirical studies (Millward, 1982; Pryke, 1982; Foreman-Peck and Waterson, 1985) which have made comparisons between public and private firms confirm that private enterprises are more efficient than their counterparts when producing the same goods or services, or their very close substitutes, using the same or very similar technology, functioning under the same regulatory constraints, and having similar capabilities.

However, some counter-evidence also exists which proves exactly the opposite. Further analysis of the empirical results shows, that, when a public enterprise is more efficient according to one indicator, its private counterpart is more efficient according to another indicator. Based on a broad survey of relevant literature, it appears that neither in LDCs (Millward, 1988) nor in developed countries (Millward and Parker, 1983; Yarrow, 1986) is there a systematic difference between the performance of public and private enterprises. A survey done by Boardman and Vining (1989, p.26),

nevertheless, reaches a different conclusion from surveys of a similar body of literature and supports the fact that there is a clear edge for the efficiency of private sector performance, but the results vary significantly across sectors. Evidence of greater efficiency of private companies appears to be in the delivery of services where governments subcontracts to the private sector and their monitoring costs are relatively low. Their conclusion is that they have obtained convincing evidence that state-owned and mixed enterprises are less profitable and less efficient than private companies.

It can be suggested that one of the main reasons for increased efficiency is the change in management behaviour. If the low efficiency of a public company results from red tape, market forces introduced through privatisation should be welcomed because they will free the management of the company from some of the former bureaucratic constraints. If the low efficiency of a public enterprise results from a socially desirable contribution to government objectives other than allocation, for example redistribution of income, then the government could consider regulation of the enterprise, even after its partial or total privatisation.

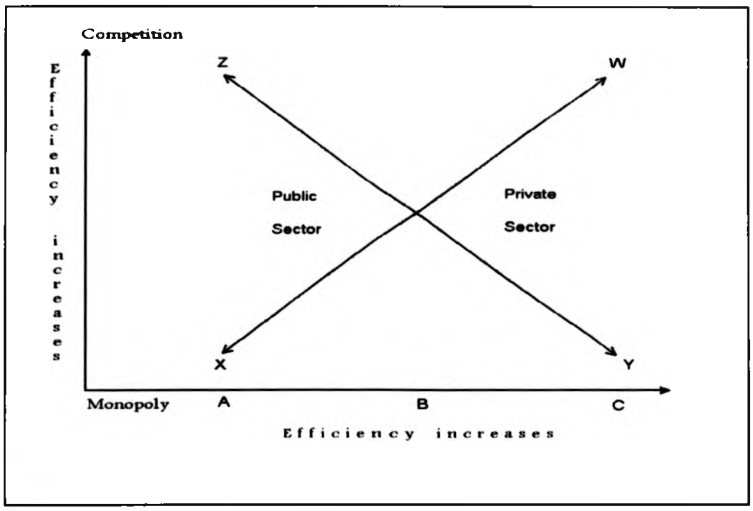
Improvements in efficiency are, however, only one dimension of the economic aspects of privatisation. There are other factors such as distribution and stability which are very important in the context of the privatisation programmes of transition economies of Eastern Europe (Ferguson, 1992; Jackson and Price, 1994).

Efficiency also focuses attention on question of ownership. It tries to determine how property rights should be organised to ensure the most efficient short-run utilisation of productive resources, or how the degree of competition faced in the product market influences performance or efficiency of the firm. Theory and evidence seem to be less clear-cut on the issue of the relative efficiency properties of different

ownership structures than would appear to be the case on the basis of the privatisation in the 1980s. While some accept the role of ownership structures but argue that the issue of market versus non market allocation is far more complex than is often allowed by the proponents of privatisation (Pitelis and Clarke, 1993, p.5), others have a much more radical view on the issue. Rees, for example, argues that "improvements in the economic performance of public enterprise are perfectly possible without a change in ownership" (1994, p.47). However, the evidence suggests that the move from public ownership is associated with improved performance, though improvement is not guaranteed (Parker and Hartley, 1991, p.640).

Two broad forces, identified in economic theory, lead to high allocative and productive (technological) efficiency. They are the capital market and the product market. The latter is primarily concerned with the basis of productive efficiency. These forces are presented in Figure 1.1 below. The horizontal axis represents the capital market and the vertical axis represents the product market. Point A on the horizontal axis represents the position of a company which is directly controlled by the government. As it is politically controlled there are no tradable shares, so it would be expected, considering the theories of public choice and property rights, that efficiency will be low. Point B shows the boundary between public and private ownership. From point B to point C, a gradual shift occurs for private firm close to the public sector (because of state funding or a reliance on state contracts), to joint stock companies and private ownership with the least attenuated property rights (point C). As shown in the diagram, efficiency increases from point B towards point C for the privately owned companies.

Figure 1.1: Graphical Presentation of Efficiency Improvements



Source: Parker (1994), p.153.

Movements upwards on the vertical axis correspond to a shift away from monopoly towards more intensive competition and thus greater product market pressure on the firms to be more efficient. Figure 1.1 hence provides a graphical presentation of the expected relationship between ownership and performance in relation to competition. The graphical presentation as discrete points is a simplification of the continuous dimensions of the presented variables. The schema implies the following:

First, changes in ownership involve movements from state towards private ownership and control (X to Y direction of movement), but when no changes in competition occur, improved efficiency will be due to changes in the capital market. Second, increased competition without changes in ownership (X to Z direction of movement) will be associated with improved efficiency due to changes in the product market. Third, changes in ownership involving a movement away from private

ownership towards public ownership (Y to X direction of movement) will be associated with reduced efficiency due to changes in the capital market. Fourth, less competition, even where there is no change in ownership (Z to X direction of movement), will lead to a reduction in efficiency.

The largest efficiency gains are likely to be associated with movements from X to W, i.e. towards private ownership and more competition. The reversed direction of movement from W to X, i.e. involving increased political control and ownership and less competition, is likely to lead to considerable deterioration in efficiency. Movements either way between positions Z and Y involve an ambiguous result because the changes in the product and capital market constraints on managerial behaviour conflict.

Based on the discussion above, Parker (1994) makes the following hypothesis: Changes in ownership from public to private, especially when associated with increased competition, are likely to result in significant improvements in efficiency. The promotion of competition also has implications for discussion on the role of regulation of privatised public utilities. The property rights and public choice theories suggest that privatisation of monopolies can lead to some efficiency gains (but it is very likely that these gains will be higher profits and not lower prices). The largest efficiency gains from privatisation, however, will occur where privatisation is associated with more competition. As "natural monopolies" prevent efficiency from competition, regulation should create managerial incentives similar to those which exist under competition and stimulate allocate efficiency.

1.7 Privatisation, Competition and Regulation

One of the major aims of privatisation is to improve economic efficiency. However, a change from state to private ownership alone is not enough to accomplish this goal. Competition is crucially important to stimulate efficiency. Cook and Kirkpatrick argue that "allocative efficiency is a function of market structure rather than ownership. Thus, in the absence of competition, privatisation in the form of asset sales is unlikely to result in gains in allocative efficiency" (1988, p.20). In the case of the privatisation of monopolies such as public utilities, it may be possible to introduce competition, for example, by licensing of competitors in competitive or contestable segments of the privatised industry. Vernon argues that "the threat of entry is sufficient to inhibit firms from earning monopoly rents" (1988, p.37). Privatisation does create competition in the markets in which the newly privatised enterprises operate. As competition increases, it enhances quality and improves performance. Competition ensures the highest quality at the lowest prices.

In the absence of competition, however, effective regulation is necessary in order to protect consumer welfare. Since competition is the best regulator, the aim should be to introduce economic regulation where necessary and economic competition where possible. Any perception that privatised monopolies are using their monopoly power to seek economic rents without due regard to the interests of consumers could seriously damage the credibility of the privatisation process.

It is argued that governments may have reasons for limiting competition in privatised industries (Veljanovski, 1989; Thompson, 1990; Baldwin, 1990). The introduction of significant level of competition into monopoly industries in most cases requires a complex restructuring which may delay privatisation, in particular if there is an opposition for such restructuring from the management of the enterprises. Delay

for governments who are especially enthusiastic about privatisation, may not be acceptable for their political timetable. More importantly, governments would like to succeed in selling the public enterprise, and this can be achieved more easily if the monopoly position of the company is retained. As discussed earlier, governments usually fear that the removal of monopoly position of the firm would greatly reduce the attractiveness of the privatised share offers on the stock market, or may jeopardise some sales, but also likely reduce revenue from privatisation. At this point, for most governments, a clear conflict appears between the main economic aim of privatisation - increasing competition and efficiency - and the broader political aims of privatisation such as wider share ownership and raising cash for the budget.

Thus, in the absence of competition, the creation of regulatory agencies was the only way to protect the consumer from the possibility of exploitation. As a result, five monopolies in Britain between 1984 and 1991 are regulated to curb their dominant market power. The establishment of regulatory agencies for each of the privatised industries, including OFTEL, OFGAS, OFWAT and OFFER,[18] was the result of privatisation besides the involvement of the Monopolies and Mergers Commission (MMC) and the Office of Fair Trading (OFT) in this process.

The first major economic regulation was introduced in 1984 when British Telecom (BT) was privatised. The privatisations of British Gas (BG) and the British Airports Authority (BAA) brought further regulation in these sectors. Though BAA is not a natural monopoly, it required economic regulation because it owns and controls London's three airports. The Civil Aviation Authority (CAA) was assigned for

[18] They stand for the Office of Telecommunications, Gas Supply, Water Services and Electricity Regulation respectively. Each regulatory body is overseen by a Director General appointed by the Secretary of State for a fixed term, normally five years.

economic and other regulatory responsibilities of BAA. The next two industries to be regulated were water in 1989 and electricity in 1990-91.

There are a number of regulatory methods which are appropriate in various situations and a choice of options concerning the regulatory framework. Governments around the world use different types of structural and economic regulatory forms depending on their objectives from privatisation. In the UK, price cap formula (price regulation), as suggested by Professor Littlechild in 1983, was accepted and continued to be used in all privatised industries which had a natural monopoly component.

This formula took the form of RPI minus X, where RPI stands for the retail prices index, conventional measure of inflation, and X represents an efficiency factor. The value of X is set in advance of a period of at least a year. The privatisation of the water industry introduced a K factor, which was to be added to the RPI whilst the gas privatisation introduced a Y factor, where Y represents permissible cost pass-through which related primarily to matters outside the control of the relevant company (Helm, 1988; Beesley and Littlechild, 1992; Price 1994a; Richardson, 1994). The principle underlying the X factor is to force a company to pass on to its customers some of the efficiency gains accruing from privatisation whilst simultaneously providing it with an incentive to reduce costs. This arises because, if it can reduce its costs by more than the X factor which is pre-set, it gets to keep the difference for itself.

Even though the RPI-X formula was used by the regulatory bodies to restrict price increases in the privatised monopolies, it still has some important limitations. The formula only applies to those services offered in non-competitive markets. So, for example, about half of BT's revenue is not subject to price control, or regulation of BAA does not include the duty-free shops which bring much of the profits and revenue.

The precise form of regulation also depends upon the structure of the privatised industry. Some industries in the UK have been privatised as vertically and horizontally integrated monoliths (telecommunications and gas), and the companies of these industries continued to perform as de facto monopolies. Others have been broken up into regional companies (water and electricity) before the privatisation partly in response to the criticism of earlier privatisations such as BT. In the latter case, the natural monopoly element is to a certain extent neutralised and is easier to regulate. In the case of water industry, ten regional water companies were privatised separately. This practice was also repeated for the regional electricity companies. The electricity industry is further divided vertically into generation, transmission and distribution (supply) companies with generation also split horizontally as National Power and PowerGen (Helm and Yarrow, 1988; Foster, 1992; Price, 1994a). In 1991, the government also decided that the further liberalisation of the telecommunications market was necessary to encourage other companies to compete with BT and Mercury. However, it is claimed that this is still long way from creating effective competition in the sectors concerned (Marsh, 1991).

The privatised monopolies in the UK have been the subject of considerable controversy due to the perception that regulation is failing the consumers because the regulatory system has been unjustifiably soft on the privatised utilities and that regulators have not been immune from political pressures. One area of concern is related to the soaring profits and dividends of certain privatised utilities such as the regional electricity companies, as well as huge pay increases of the management of those privatised utilities.[19] Thus, the critics argue that the soft approach of regulators

[19] British Gas, for instance, increased the salary of its Chief Executive, Cedric Brown, by up to 75 per cent in 1994. This huge pay increase which was over a million pounds per annum with the share options, was justified in terms of making the company's pay structure 'internationally competitive'.

towards the privatised utilities has brought little benefit for customers, while shareholders have been major beneficiaries of privatisation in utility industries (Richardson, 1994, p.79; Clarke, 1993, p.223-4).

Information, however, appears to be the principal issue in effective regulation. The regulator's ability to set a realistic and fair price cap depends on his access to sufficient and accurate company data concerning operating costs and the cost of capital besides other relevant things. Utilities have every incentive to inflate costs and disguise the potential for efficiency gains since the regulatory regime allows them to retain the profits until the next price review. Since the privatised utilities control the information and the regulator does not, the bargaining position of the former is consequently much stronger.

Concerns about the effectiveness of the current UK regulatory system have prompted suggestions for the establishment of a panel of advisors who will provide independent regulators advice on complex and confidential policy issues. Nevertheless, it is the information monopoly of the utilities that poses the biggest obstacle to efficient regulation and, in this respect, it seems that there are no easy solutions at present.

The present regulatory system is perhaps not a perfect model but it has nevertheless worked quite well. It has succeeded in reducing utility prices, for example, in telecommunications, where the price of calls has dropped by an average of approximately 40 per cent in real terms since privatisation in 1984 and in the gas industry where prices have been reduced by 20 per cent in real terms. Even in the electricity industry, the August 1994 price review imposed one-off cuts of between 11 and 17 per cent in distribution charges and limited future annual price increases to RPI-2 (*The Economist*, 25.2.1995). The current regulatory system also has the virtues

of speed and considerable political independence which will need to be maintained in any new system (Prosser and Moran, 1994). The main lesson to be learned from the current debate on regulation of privatised utilities is that competition is an essential factor for the success of utility privatisation and that regulation can only be a second best solution.

In short, as Price (1994a) observes, much of the rhetoric surrounding privatisation suggests that private markets should be superior to public ownership without the need for regulatory intervention. However, the presence of monopoly power in the UK economy has prevented such a happy outcome yet.

It is argued that the subordination of the objective of achieving economic efficiency in the industries to be privatised to the government's immediate political priorities to raise short-term revenue and secure quick sales of public assets, has not only undermined the logic of the government's case for privatisation, but more seriously has provided vital sectors of British industry with a comfortable private monopoly which will now be extremely difficult to break. As Vickers and Yarrow conclude in their study that:

> In the long run the British privatisation will be judged in terms of its effect on economic efficiency. By failing to introduce sufficiently effective framework of competition and regulation before privatising such industries as telecommunications and gas, the Government has lost a major opportunity to tackle fundamental problems experienced in the past under public ownership (1988, p.425).

The problems of regulation encountered in the developing countries, however, are more acute than the UK. Privatising and regulating natural monopolies in such circumstances is a formidable task, and it underlines the importance of achieving an appropriate structure for the industry. Most Latin American countries, for instance, have been or are privatising sectors which are natural monopolies. One of the major issues for the policy makers in these countries is the type of regulation which will be

developed in an increasingly privatised economy and the manner in which such regulation will be carried out.

The rush towards privatisation of natural monopolies was so rapid that in most countries there was not enough time to establish a definite regulatory framework. Moreover, regulatory agencies in some cases were not able to make the rules of the game clear and stick to them in the post privatisation period. In the case of the privatisation of Chilean telecommunications company (CTC), for example, there were no clear-cut rules of the game concerning competition and entry into the sector. So, problems started to emerge when another firm had intended to enter the market. Important investment plans in the sector had to be postponed pending a court decision to find out whether the other companies had the right to enter the Chilean telecom market (Baer, 1994; Galal *et al.*, 1994).

The privatisation of ENTel, the Argentine telecommunications operator, provides another good example of the importance of establishing a proper regulatory framework before privatisation. In this case, the regulatory regime was not defined until the very end of the selling process for ENTel, following several major modifications during the process itself. This was partly due to a conscious decision on the part of the Argentine government to give priority to a speedy conclusion of the sale. In addition, the Argentinian government was able to avoid a number of political hurdles and problems by postponing the development of a regulatory framework. The failure of setting up a regulatory system had a negative impact on the telecommunications sector and the government had difficult problems with the revision of the tariff formula in the later stages of the privatisation.

However, the Mexican government followed a different regulatory system for the privatisation of its telecommunications operator, Telmex which was privatised in

1990. The Mexican telecommunications sector was first liberalised before its privatisation. The Ministry of Communications and Transport has been assigned as the regulatory entity on telecommunications issues. The government's new regulatory environment permitted infrastructure competition in local telecommunication services and mobile communications while long-distance telecommunications, one of the most profitable industry segments, would remain reserved for Telmex up to 1997. Furthermore, the Mexican government decided on a negotiated contractual concession which would produce the quantity and quality of the service needed, instead of a price cap formula. This was an essential point for the less developed Mexican telecommunications infrastructure then. The monopoly privileges granted to Telmex over long-distance services was a part of the deal which required Telmex to expand its number of subscribers by at least 12 per cent per annum and to provide a telephone service to all villages of more than 500 inhabitants by 1994. The evidence shows that Telmex has so far achieved the targets set both in quantitative and qualitative terms. In return, Telmex's monopoly power in the market has provided the company a considerably high operating income (Galal *et al.*, 1994; Rey, 1995).

There may be lessons to be learned from the Mexican case. It shows how to privatise a natural monopoly successfully and regulate if it is necessary, so that the targets set by the government can be reached and competition can expand services for the benefits of the telecommunication consumers (Aspe, 1994).

1.8 Political Aspects of Privatisation

Besides being a complex issue because of its economic, social, legal and technical aspects, the decision to privatise has a political dimension too. Politics perhaps plays the most important role in deciding whether or not to privatise, and what to privatise. The record of privatisation shows that since the early 1980s in the UK

and between 1986-1988 in France, the privatisation programmes have been ideologically inspired and rooted in a wider strategy, whilst more pragmatic requirements were dominant factors rather than the ideology in privatisation elsewhere. Furthermore, the strong ideological backing for privatisation extended its scope and nature in the UK and France compared to any other developed, and possibly developing country (Vickers and Wright, 1988).

Thatcher and her government proved to be the most radical in privatising the public sector enterprises. The successive Conservative governments have transferred most public enterprises to private ownership. No industrial sector has remained untouched. Several public enterprises from competitive industries (NFC) and monopolies and quasi-monopolies (BG, BT, electricity and water) to major strategic industries (British Aerospace, BP, Britoil and British Airways) and heavily subsidised public services (railways) were all privatised.

In France, the privatisation programme was made up of about 65 public companies to be privatised by 1991 which employ 750 thousand wage-earners. It is claimed that the success of the French privatisation programme owes much to the lessons drawn from the experience of the British privatisation programme (Redwood, 1989). It has displayed, for example, a firmness of purpose and speed in its legislative process compared to a separate piece of legislation required for each major privatisation in the UK. The French programme has seemingly adopted many of the practices of the UK programme too. It gave particular attention to the mass marketing techniques to boost the size of the stock market and bring new savers into the ownership process. Even though the French privatisation programme did not include the transfer of public utility monopolies such as gas, electricity and telecommunications, it is still one of the largest privatisation attempts in terms of the

number of shareholders involved and the amount of income raised. The French state owned a large competitive industrial and financial sector to privatise before turning to the privatisation of its public utilities (Dumes and Jeunemaitre, 1994).

It looks as if the French government with its privatisation programme since 1986 is probably the second largest and important privatisation case in terms of the number of new shareholders involved and the revenue generated. But the British privatisation has still its uniqueness in terms of its success in redrawing the public-private boundary. The British public enterprise sectors has almost been eliminated by 1997 from being one of the largest in Europe in the late 1970s (Heald, 1988b, p.36).

However, it is argued that early justifications of privatisation in Britain were based on economic arguments that greater competition would result in gains in efficiency as well as easing the pressure of public expenditure and borrowing on government. After the election of 1983, the Conservative government increasingly discovered the political benefits of privatisation. Increasing revenue from the privatisation was an alternative source of income for the government instead of tax raises or public sector spending besides helping the government to reduce the PSBR (Thompson, 1990). As Brittan sees (1984, p.110), "selling public assets was politically much easier, and more popular, than cutting public expenditure". Privatisation was not originally a major part of party policy. It emerged and progressed gradually rather than being planned rationally as an element of a political strategy. Bishop and Kay (1988, p.10), for example, note that privatisation was "a policy which was adopted almost by accident but has become politically central; a policy which has no clear-cut objectives, but has become almost an end in itself". This was indeed clearly acknowledged by the government. Letwin, who was an advisor to Thatcher, said that:

> We had no coherent policy. It was not the case that we knew that privatisation would bring in millions of new shareholders. ... these shareholders would benefit from premiums. ... It came upon us gradually and by accident and by a leap of faith (cited in Foster, 1992, p.109).

One of the main concerns of the Thatcher government was the objective of curbing trade union power. It is claimed that successful privatisation of public enterprises would help the government in two ways: it would distance the government from politically sensitive and damaging public sector industrial relations disputes, and would reduce the bargaining power of public sector workers' unions and their influence over policy (Marsh, 1991).

As the privatisation programme progressed, it came to be justified in terms of the benefits of wider share ownership, which is also a widely used argument in France. Today it is acknowledged that privatisation in the UK has increased the number of shareholders to 13 million by the end of 1992 from 3 million in 1979, which represent 22 and 7 per cent of total adult population respectively. In France, too, the number of shareholders increased three fold between 1986 and 1988 (Wright, 1994, p.35, Marsh, 1991, p.474). Critiques of the privatisation programme argue that most of the original shareholders did not retain shares but sold them after making a quick profit. Yarrow (1986), for example, noted that:

> "Within one month of flotation, the number of shareholders in Amersham International had fallen from 62,000 to 10,000; within one year of flotation, the number had fallen from 150,000 to 26,000 in Cable and Wireless (first tranche) and from 158,000 to 27,000 in British Aerospace" (p.357).

The resale in sales such as BT, BG and the Trustee Savings Bank (TSB) did not occur so quickly. The government learned from its earlier mistakes. New shareholders were given loyalty bonuses if they held on to their investment for some time usually three years (vouchers to set against phone or gas bills, one-for-ten

bonuses for those who hold on to shares). Purchase of shares was also made as easy as possible whereas resale requires a broker.

It is estimated that the percentage of original shareholders who retained their shares averaged around 60 per cent which may be now around 40-50 per cent. The majority of these new shareholders sold their shares after securing the benefit of the initial discount by the privatisation. Therefore, the great majority of shares have ended up with the financial institutions (Buckland, 1987, p.254; Bishop and Kay, 1988). This led to comments that as a result of privatisation there has been "a widening, but not deepening, of share ownership" (Marsh, 1991, p.475).

It was also claimed that the government gained political advantages from the privatisation programme in the UK (Vickers and Yarrow, 1988). Studies done by several authors (Crewe, 1988; Veljanovski, 1989; Dobek, 1993; Saunders, 1995), however, suggest that privatisation might have become more popular over the time among the voters and the Conservative Party might have gained votes, in particular the votes of those who bought council houses, or of those who benefited from privatisation in other ways.

The ideological underpinning of privatisation, especially the view of the New Right, has already been examined earlier in this chapter. In Britain and France, privatisation has come to be seen as a part of a general strategy to change the boundary between public and private in favour of the latter. In France, the privatisation programme of 1986-88 symbolises the struggle against the technocratic elites and the long tradition of etatism. The British privatisation, on the other hand, was an attempt to alter the excessive state intervention associated with neo-Keynesian economic policies. Thus, in that respect, it is a policy of Thatcherism in the 1980s

much more to do with ideological belief than economic analysis and comparative assessment of performance.

The impact of privatisation upon politics in LDCs and developing countries has been more influential and carries with it great political risks. The majority of developing countries have involved in privatisation for practical reasons such as reducing the level of their debts, and as a result of pressures from the World Bank and the IMF to reform public sector enterprises, rather than being inspired by strong ideological objectives. But for some governments in developing countries, privatisation has also provided an opportunity to make steps towards a market-oriented economy in contrast to socialist or etatist policies which were implemented by their predecessors. This made privatisation a political process. Cases in point are Chile where the Pinochet military regime used denationalisation to reverse the socialist characteristics of Chilean economy under Allende, and Turkey where the Özal government attempted to liberalise the Turkish economy and to privatise state economic enterprises in order to reduce the role of the state in the economy which largely resulted from a half century of etatist policies.

Given the fact that most developing countries lack the necessary conditions to carry out privatisation (e.g. an efficient capital market, potential domestic investors, necessary know-how), the privatisation of SEEs has raised very sensitive questions of sovereignty and security when the enterprises to be privatised are of economic significance, strategic and/or military importance. Even the privatisation of ordinary or competitive enterprises has caused a political stir in some developing countries when the majority of buyers of shares of the newly privatised enterprises are foreigners. For instance, the court cases against the privatisation in airline catering

and cement sector in Turkey created a period of uncertainty for the government officials and the buyers.

1.9 Consequences of privatisation: the UK case in perspective

Assessing the impact of privatisation is an enormous task to achieve due to the fact that the variety and extent of privatisation programmes is as great as the range of countries mentioned in this chapter. Some of the consequences of privatisation programmes are easier to identify and assess than others. Furthermore, while evidence about the short- and medium-term consequences is already emerging, the long-term consequences (costs and benefits) of privatisation remain to be seen. Yet, again, given the scale of recent privatisation (e.g. railways in the UK), it would be premature to draw authoritative conclusions in this regard.

Nonetheless, as discussed earlier in this chapter, the UK privatisation programme has frequently been presented by politicians, industrial consultants, and by some academics as a resounding success and a major contribution to the revival of the economic fortune of the country. Though more analytical and critical assessments of the British privatisation programme have also emerged such as the influential study of Vickers and Yarrow (1988), the British experience with privatisation has been recommended as a blueprint for other countries (Veljanovski, 1987; Heald, 1988a; Hemming and Mansoor, 1988; Cook and Kirkpatrick, 1988; Clarke, 1993).

Any assessment of the achievements of privatisation must be done within the context of the objectives set by the government. From the government's perspective, four major successes can be claimed for privatisation in the UK. *First*, privatisation has certainly delivered large revenues to the Treasury. *Second*, it has widened share ownership in the UK. *Third*, it has produced a dramatic reduction in the size of the

state owned sector of industry. *Fourth*, and much more controversial, it is claimed that the privatised industries have become more efficient. Let us review these various claims.

Since the beginning of the privatisation programme in 1979, 48 major businesses have been transferred to the private sector, bringing in proceeds of £65 billion. Today, the privatised companies contribute £55 million a week to the Treasury in taxes while the same SOEs used to cost British taxpayers £50 million a week in subsidies in 1981 (*Euromoney*, February 1996). The British government has obviously benefited from the proceeds of privatisation to lower taxes, and to sustain public expenditure besides the long-term benefit of the revenue raised in tax from the privatised company profits.

The Conservative government in the UK was able to reduce the share of the state sector within the economy, mainly the nationalised industries, 2.3 per cent of GDP currently whereas the figure was 11 per cent of GDP before the privatisation programme started. The number of employees in nationalised industries have also fallen by more than two-thirds to half a million and around one million jobs have been transferred to the private sector (Ernst & Young, 1994, p.xi).

However, despite a huge amount of privatisation income, there are also important transaction costs that need to be offset against any gains. Privatisation is not costless. The agency costs of floating new shares on the stock market, for example, are estimated at around £3 billion in the UK while the costs of discounting the new share prices at the time of floatation is thought to be around £2 billion which brings the total to £5 billion. The critics of the privatisation argue that the government sold valuable assets cheaply in order to ensure that the privatisation programme succeeded (Buckland, 1987). They, for example, emphasise that much of the

restructuring of the corporations took place as a preparation for privatisation with the injection of massive amounts of public money. In Jackson and Price's (1994, p.11) term the government "fattened the calf before taking it to market". This had a cost for the taxpayers too. Richardson *et al* (1992) note that before its privatisation, the water industry had £5 billion of debts written off and received another £1.6 billion for new investments. The high cost of redundancy payments and unemployment benefits to the workers who lost their jobs either in the process of pre-privatisation restructuring or following the privatisation should be added to the cost of privatisation.

The privatisation programme in the UK initiated a huge and unprecedented expansion in the number of shareholder commencing with the BAe sale in 1981. The sale of BT to millions of individual investors introduced the notion of wide share ownership and 'popular capitalism' (Redwood, 1989). This trend continued with the sale of other large state enterprises such as BG, water and electricity industries. The aim was to gain political advantage by creating a shareholders democracy. As a result, today there are 13 million shareholders in the UK compared to 3 million in 1979. The success of the share floatations and the subsequent capital gains by investors was seen by critics to be a result of underpricing of the issues and failure to maximise proceeds of the sale.

Has privatisation improved efficiency? It is difficult to measure improvements in efficiency. Profitability is not a particularly helpful guide for a variety of reasons. For example, a firm can be very profitable because of its monopoly power or unprofitable because of government imposed price rules or social service costs. Thus, it is problematic to adjust these factors in any performance assessment. However, the available evidence on improvements in efficiency is found to be confusing, contradictory and far from being conclusive. It is generally argued that performance,

in terms of production, sales and profits, has improved in the UK since privatisation (Wright, 1994; Bishop *et al.*, 1994). When public enterprises have been compared with the nearest equivalent private firms the latter have come out on top more often but this is by no means a universal conclusion.

Nevertheless, there are a number of studies which attempt to test the effect of ownership in a competitive environment. Where multi-sectoral and multi-country comparisons have been conducted, excluding sectors such as posts and railways, the results mostly support the hypothesis that in competitive environments privately-owned companies outperform their public counterparts both in terms of productivity and profitability, a conclusion which is unaffected by adjustment to allow for differences in size and industry structure.

One of these studies was carried out by Parker (1991) and it attempts to examine the effects of ownership on economic and financial performance. This study only includes two cases of a transfer from the public to the private sector (BAe and NFC), but also covers one prospective privatisation, two ownership changes from private to public and a variety of significant changes of status within the public sector.

The study shows that in five cases, including the two privatisations, performance was improved through exposure to the market. On the other hand, the non-privatised Rolls-Royce appeared to have benefited from being taken into public ownership and there was no clear improvement in the other cases. This led Parker (1991), the author of the study to conclude that a shift from the public to the private sector "may improve performance, but this improvement is not guaranteed. Performance improvement may depend upon other factors than ownership" (p.159).

Some other studies (Bishop and Kay, 1988; Thompson, 1990) could not find any significant improvement in productivity following privatisation though the picture was

patchy when a profitability measure was used. Foreman-Peck and Manning (1988) compared BT with its European counterparts and concluded that it did not perform better than the state-owned monopolistic telecommunication firms elsewhere in Europe. Dunsire *et al* (1991) found that if they used total factor productivity as a measure of efficiency and compare the total factor productivity of the newly privatised enterprises with the national trend, then only the National Freight Corporation was above the trend.

A more recent study done by Galal *et al* (1994) examines three privatisations in each of four countries active in privatisation including Britain. It covers three telecom firms, two electricity utilities, a road-freight transporter, a container port and a national lottery, mostly privatised between 1984 and 1988. The findings of the study show that in 11 out of the 12 cases privatisation produced an increase in wealth which cannot be attributed to any inherent bias in the choice of companies studied. The Galal *et al.*'s study take the interests of workers, consumers and shareholders, and others into account, and it claims that all of them have gained in some way. However, one survey of the literature contends Galal *et al.*'s findings and it concludes that "a common consequence of privatisation is increased prices to customers" (Marsh, 1991, p.469).

If the change in ownership is not a critical factor for improvement in performance, so what is important then? Economists are now generally agreed that simply changing the ownership of assets is not sufficient enough, and it may not even be necessary, to improve efficiency. What is important is the threat of competition and, therefore, market conditions and perhaps the regulatory regime (Bishop and Thompson, 1992). The sale of assets contributed little to efficiency gains and must

instead be judged in terms of the effects of change of ownership on the distribution of entitlements in the economy. Vickers and Yarrow (1988, p.425) argue that:

> By failing to introduce sufficiently effective frameworks of competition and regulation before privatising such industries as telecommunications and gas, the Government has lost a major opportunity to tackle fundamental problems experienced in the past under public ownership.

Probably the most serious criticism is that the Government concentrated too much on ownership and not enough on competition. This is the major criticism made by Kay *et al* (1986) in their numerous studies. Kay argues that it is only competition that matters and not ownership, and thus he considers neglecting the introduction of further competition as one of the failures of the government in its privatisation programme. Even a number of free market supporters have stressed this failing, as they see it, of privatisation. For example, Veljanovski (1989) tries to highlights the problems in relation to privatisation and competition.

It is claimed that competition rather than privatisation *per se* seems to be the main stimulus to efficiency improvements. It has been in industries such as steel where competition is strongest that the greatest improvements have been made (Aylen, 1994). Those privatised industries, such as gas, which still enjoy the protection created by their monopoly power, have not shown dramatic improvements in performance. Others are not completely convinced that competition rather than privatisation *per se* is the main cause of efficiency. Beesley and Littlechild (1986, p.44), for instance, argue that privatisation should promote efficiency even if there is no increase in competition. This contention rests upon two kinds of argument. The first is that regulation is more effective than ministerial and departmental control. The second is that privatisation has the clear edge over many possible public enterprise reform because of several supposedly unique features.

So, how does privatisation improve performance significantly then? It is argued that privatisation has brought about significant changes in the managerial 'culture' in both public and privatised organisations. Champ (1993) who is a managing director in the electricity industry describes these changes as follows:

> ... probably the most important single change which has taken place in our industry over the last three years has been the change in culture and attitude amongst staff. Every member of staff now recognizes the need to innovate, raise standards of customer service and, at the same time reduce costs. Decision making is being devolved to the lowest possible levels in the organisation and layers of management are being removed as fast as possible (p.12).

The study of Bishop and Green (1995, p.33) found clear evidence to support the view above. They concluded that the majority of the privatised firms in competitive industries took advantage of commercial and managerial freedoms that had been denied them prior to privatisation. Moreover, the value and the belief system has been revolutionised with the process of privatisation. There is now a greater emphasis upon establishing clear commercial objectives; measuring performance in terms of outputs rather than inputs; improving management information systems, especially financial systems; introducing effective cost control mechanisms; and ensuring that the incentive systems of rewards are compatible with the objectives.

1.10 Conclusion

This chapter has attempted to provide an analytical framework for the rest of the thesis by reviewing the literature on privatisation as practice around the world. The concept of privatisation is very complex due to the political, economic, social and financial elements involved. However, based on the analysis made in this chapter, it is possible to make the following conclusions:

Privatisation became an international phenomenon in the 1980s and governments of different political persuasions are continuing to transfer SOEs to the

private sector in the 1990s. However, although several governments have committed themselves to privatisation, the degree of commitment, scale and speed of privatisation differ in various countries, usually reflecting their specific circumstances. As one study concluded, "apart from a very few [developing] countries ... such as Chile and Mexico, the vast majority have not succeeded in substantially reducing the size of the public sector" (Ramanadham, 1993, p.1). Much of the scope for privatisation also depends on the nature and size of the public sector of industry within a country. For example, neither the US nor Japan had gone in for nationalisation programmes, thus opportunities for privatisation of industry are limited. In Japan, however, as a result of the deregulation of the domestic telecommunications sector, the state-owned NTT became a joint stock company and that brought substantial proceeds from privatisation. The proceeds from the sale of NTT and other enterprises accounted for a significant proportion of revenues in the industrialised country privatisations. In Europe, on the other hand, some governments (e.g. the Danish and the Swiss) have not been involved in the management of the industries to any appreciable extent, hence since there is no public sector to privatise, some of these governments concentrate on the issues like contracting-out of services in public administration at the central and local government level.

In general, reasons for privatisation appear to be political (rolling back the frontiers of the state, disappointment with socialism and the failure of CPEs) and economic (the poor performance of SOEs and their heavy claims on public funds). Governments throughout the world have embarked upon privatisation programmes with several goals from the sale of SOEs. Raising money to reduce budget deficits, fostering competition, promoting efficiency and encouraging share ownership among

people with small amounts of savings, thereby creating capital-owning democracies or establishing a 'popular capitalism' are some of the frequently cited objectives of privatisation programmes in various countries. In some cases, there were also conflicts among objectives of privatisation. For instance, conflicts between the objectives of promoting wide share ownership and fostering good corporate governance, and conflicts between economic efficiency and social employment objectives are just some of the contradictions in privatisation goals. The policy objectives and motives for privatisation have altered with time. The political rush to privatise and the desire of raising cash prevented many governments, including the UK, from promoting competition in some privatised sectors or made it more difficult to regulate the privatised companies effectively.

Whilst some governments, notably the British and the French in developed countries and the Mexican, Chilean and Argentinian in developing countries, have initiated highly ambitious programmes in which privatisation was an integral part of a reasonably systematic attempt to 'roll back' the frontiers of the state, many other governments in Europe and elsewhere, including in Turkey, have chosen a more modest approach by transferring only relatively small shares of the public sector to private ownership. In Germany, unification has required the restructuring of industry on a vast scale to incorporate a centrally-planned East Germany into a market economy whilst mass privatisation in the CPEs of Central and Eastern Europe involved the creation of a framework to establish a market economy with its legal, administrative and market components. In developing economies, besides the degree of political commitment to privatisation by some governments, there have also been serious obstacles in privatisation such as weak capital markets, legal and financial

difficulties, opposition by interest groups and unfavourable macroeconomic conditions, thus "process ... has been slower than hoped and actual outcomes had qualitatively disappointing. Privatisation to date has played only a small role in the reform of the SOEs sector" (Ramanadham, 1993, p.1). Even in developed countries "only a handful of countries have implemented privatisations programmes of truly significant proportions" (Stevens, 1992, p.6).

Various methods of privatisation have been used and are being tried out by governments such as direct sales to general investors, public share offerings on capital markets, management and employee buy-outs, liberalisation and deregulation, contracting-out, mass privatisation (voucher or coupon system), and grants of a statutory right to private sector to provide certain goods and services. What is the most appropriate method of privatisation will depend on the type of assets to be divested and on the nature of the country's economy as well as political choice as discussed above. Governments have determined the sale method according to their priorities from privatisation whether it would be promoting competition and thereby efficiency gains in the economy and thus ignoring the desire of raising cash for government expenditure, or vice versa.

Among the developed countries, Thatcher in the UK made privatisation the cornerstone of her government's economic policy in the 1980s. First under the leadership of Thatcher and then Major, the Conservative government has pioneered privatisation in the UK. The Thatcher government launched a wide range of privatisation programmes with the pledge of reducing the role of the state in the economy. The experience with privatisation in the UK has been so far the most radical one in terms of shifting the balance between the public and the private sector.

The share of the public sector in the UK economy has been reduced to 2.3 per cent from 11 per cent of GDP in 1979. The UK government has privatised most of the state enterprises from firms operating in relatively competitive markets (steel, airline, freight) to public utilities (telecom, gas, electricity, water) as well as services previously provided by the local and central government (rubbish collection, Benefit Agency). The Major government has continued with the privatisation in other sectors such coal, railways in the 1990s. The privatisation programme has not only generated a huge amount of money (over £65 billion) for the government but it also created a valuable opportunity to gain experience from the process which has been now exported to other countries as British 'know-how' on privatisation.

Moreover, though it was a particularly difficult and controversial task, the British experience has also showed how the privatisation of 'natural monopolies' and 'utility industries' (telecommunications, gas, water and electricity) can be achieved and, how a fairly effective regulatory system can be set up to protect the interests of consumers in the sectors where competition is a missing component. This is why most of this chapter has concentrated on the British privatisation experience.

It has been long argued that privatisation would improve economic efficiency. This debate is usually carried out at the theoretical level. The property rights theory of the firm suggests that public enterprises should perform less efficiently and less profitably than private enterprises because public enterprises are not subject to the discipline of capital markets. Existing empirical evidence is not clear-cut enough to support this hypothesis without qualification but, overall, the evidence suggests that private enterprises are generally more efficient than public enterprises, even if the conclusion is ambiguous. As discussed above, this has led to the conclusions among

several authors that while a change in ownership is significant as a factor in improvements in efficiency, it is less important than competition and regulation. Indeed, as the British experience has shown (e.g. BT, BG), if efficiency gains are to be attained in a large public utility or natural monopoly, it is not sufficient enough to privatise the enterprise. The privatised enterprise either must face the threat of competition in the marketplace, or if the government wishes to retain the monopoly status of the enterprise, it is suggested that the desired efficiency gains may be achieved by establishing a regulatory framework and perhaps additionally exposing the enterprise to competition. Private ownership is preferred to public ownership in markets where reasonable competition exists.

However, more recent studies have examined the balance between private and public industrial companies by conducting multi-country and multi-sectoral comparisons and by excluding service sectors such as posts, railways and public utilities. The results clearly support the hypothesis that in competitive environments privately-owned industrial companies outperform their public counterparts both in terms of productivity and profitability.

Thus, as a general conclusion, it is possible to say that privately owned firms outperform their public counterparts in competitive markets. The case for natural monopolies does not allow one to reach such a conclusion yet. But the nature of a 'natural monopoly' (a firm not subject to the law of diminishing returns, whose costs fall indefinitely as it increases its output) has changed today as a result of technological advancement, deregulation and privatisation.

Telecommunications was once considered a natural monopoly. Today, thanks to new technology (e.g. interconnection facilities, digital technology and mobile

communications) and deregulation, it is an intensely competitive business. BT is obliged to allow interconnection to new entrants such as Mercury in the UK. It seems that competition would enhance in many other countries too if governments removes remaining restrictions in the sector. The supply of gas is also a potentially competitive market with a number of producers and various import possibilities. As with the electricity industry, regulation will have to protect the captive household segments of the market from exploitation.

However, it may be reasonable to wait for an assessment whether privatisation of natural monopolies has brought any significant and lasting improvement in economic performance. Furthermore, more studies from countries other than the UK may be helpful to test the hypothesis above which, to a certain extent, this study intends to do.

In conclusion, after a decade and half experience, the emerging evidence suggests that the concept of privatisation in its different forms is not a panacea for all the ills of an economy. It can create new problems while solving old ones or recreates the difficulties or problems which SOEs tried to take care of. Privatisation has been implemented and is underway in many industrialised and developing countries. The experience of some of these developed (e.g. the UK and France) and developing (e.g. Mexico and Chile) countries supports the view that a well designed and well executed privatisation programme will bring a positive impact on economic development and the general public will share the welfare gains of the process in the long run.

This chapter largely assessed economic and political aspects of privatisation in a number of developed and developing countries. It is hoped that the lessons to be drawn from the analysis of the successful privatisation programmes in Britain and in

some developing countries such as Mexico, would be useful to Turkey and others facing similar challenges in their efforts to privatise their SOEs.

In particular, the British experience with privatisation is examined in detail and frequent references are made to the British privatisation programme in the rest of the thesis because privatisation in Britain is generally considered as a great success. The British case shows how the privatisation of public enterprises, from small scale enterprises to 'natural monopolies' or 'utility industries', can be undertaken step by step and how a fairly effective regulatory system can be established to minimise the negative impact of privatisation on consumers in the sectors where competition is missing element. It also shows the relatively smooth operation of a major policy implementation and the successful use of different privatisation methods within a well developed market economy. Hence, the privatisation experience in Britain has created a valuable opportunity for other countries to learn from the British 'know-how' on privatisation and design a privatisation policy which is suitable and adaptable to the specific country conditions.

The British privatisation can be readily related to the Turkish case too. Since the early 1980s, the former has been seen as a role model by the Turkish policy makers and, thus as will be often mentioned in the rest of the thesis, the British case has influenced Turkish privatisation since its earlier stages in several ways. Firstly, similar to those policies pursued in the UK, the new liberal ideology and the notion of privatisation became the policy of the centre-right, Motherland Party, under Özal's leadership and was intended to change the etatist policies of the past in favour of a market oriented economy which would reduce the role of the state. This turned the Turkish privatisation policy into a political process as well as an economic one. In

contrast to the UK, the lack of economic and political stability combined with insignificant political determination to privatise can be regarded as one of the reasons for the failure of Turkish privatisation programme. Secondly, it is possible to observe some other influences the British privatisation had on the Turkish case. For instance, it is argued that by selling revenue sharing certificates to the public and by relating the privatisation of mass housing, the Özal government attempted to pursue Thatcher style popular capitalism in Turkey (Önis, 1991b). Thirdly, over the past decade, the British expertise on privatisation has been offered to Turkey and numerous British consultancy firms, experts and academics have been advising the Turkish government on the issue. Therefore, it is thought that an analytical and a critical assessment of the British privatisation programme, since it was recommended as a blueprint for other countries including Turkey, can be useful for the analysis of the Turkish case as will be discussed in the following chapters.

CHAPTER 2: The Emergence of the State Economic Enterprises in Turkey

2.0 Introduction

This chapter examines the foundations of the Turkish SEEs with particular emphasis on the Kemalist development strategy in the context of the Republican economic history in the last 60 years. The Republic of Turkey was formed as an independent state which emerged from the remains of the Ottoman Empire at the end of first World War. The leadership of the country initiated immediately a series of radical changes in its social, political, and economic systems. The guiding force behind this transformation was Mustafa Kemal, popularly known as Atatürk, who was Turkey's undisputed leader from 1920 until his death in 1938. Between 1923 and 1980, Turkey followed a national economic policy that was intended to open a new era of prosperity and higher living standards for the Turkish people. The chosen development strategy was '*Etatism*'. Under this strategy, the state assumed that it was its responsibility to have direct control of resource allocation through economic planning and public enterprises.

Thus, the primary focus of this chapter is to examine the Kemalist state and its role in national economic development in the period from the early 1920s to the 1980s. Within this broad framework, the main purposes of the analysis are; firstly, to examine the 'leading' role of the state in economic activity with the development idea of 'etatism' as well as its guiding rationale for economic policy which lasted about 60 years in Turkey; and secondly, to study etatism and its vigourous implementation through SEEs which mushroomed in almost every sector of the Turkish economy.

This will also allow me to assess the place and importance of SEEs within the Turkish economy from the early 1930s up until the 1980s. In addition, it is interesting to examine the Turkish case as an example of the oldest but not the most successful model of a developing country which chose development by planning for over a half-century.

The economic policy discussion in the context of the Republican economic history will be broadly divided into five different periods in this study. In this context, the period of 1923-29 appears to be an era when there were attempts "to lay down the foundations of a private enterprise economy". The next two periods; (1930-1950) and (1950-1960) are then defined, respectively, as periods of "etatism" and "liberalism". The fourth period between 1960 and 1980 characterises an era of "experimentation with a planned economy". Finally, the 1980s is presented as a period of "returning of economic liberalism" and it will be examined in the next chapter.

2.1 The Experiment of Private Enterprise Economy in the 1920s

The Republic of Turkey was officially founded in 1923 in an economic and political vacuum. This was a time of widespread devastation where farms and infrastructure were in complete ruins after years of war and destruction, and the country had virtually no manufacturing base. Trade was seriously paralysed. There was a shortage of capital for financing development at home but both foreign banks and capitalists were not willing to invest in Turkey. Moreover, there was also a shortage of entrepreneurial and skilled manpower which was urgently needed for development. Trade and commerce, traditionally, had been in the hands of non-Muslim ethnic groups. Some of the minority groups, mainly Greeks and Armenians, left the country after the Independence war, leaving behind a shortage of capital and entrepreneurship. According to the Treaty of Lausanne which remained in force until

1929, the new Turkish state had to continue recognising the economic concessions (known as '*capitulations*') granted to foreign firms by the Ottoman Empire since 1535. So Turkey was not able to develop a customs policy that would offset its trade deficit until 1929. It is argued that the termination of the Treaty in 1929 thus marks an important turning point for increased state intervention in the Turkish economy. When the limiting clauses of the Lausanne Treaty ended, it was possible for the government to organise the foreign trade regime in such a way so that the pressures on the public budget and balance of payments could be alleviated (Berberoglu, 1982; Bugra, 1994; Kepenek, 1990; Kjellstrom, 1990).

Despite the dark side of this picture, Atatürk, the leader of the country, was very determined to transform the country from a religious empire into a modern, Western democracy by initiating a number of radical changes in its social, political, and economic systems. In order to achieve this modern society, the Roman alphabet replaced the Arabic, the fez was outlawed, universal primary education was set as an important goal, Islamic law was replaced by the Swiss civil code, and it was declared that Turkey was a secular state (IBRD, 1951). More importantly, in the economic field, consistent with the above political and social reform initiatives, the leadership of the contry also took some important steps to transform and modernise the economy. In order to achieve this goal, first, a liberal and then an etatist development policy were chosen for the economic policy of the country as will be discussed below.

The early period of the new Turkish republic between 1923 and 1930 was under the influence of liberal economic policy. In 1923, Atatürk decided to convene an economic congress in Izmir. The Izmir Economic Congress marked the beginning of an active role for the Kemalist state in the formulation of economic policy- a policy which was to guide the post-independence economic development of Turkey along a

capitalist path. At the Congress, Atatürk declared a liberal policy welcoming foreign investment as long as it respected Turkish laws and sovereignty (Mehmet, 1990; Karluk, 1994). Further, he stressed that agricultural and industrial output should be increased. He also emphasised the great predominance of foreign capital in trade, finance and communications and its possible harmful effects (Okyar, 1965). However, the Congress ended with the reaffirmation by the state of its commitment to protect national economy and carry on its 'modernisation' and 'development' programme along capitalist lines. While granting the main economic role to private enterprise, the state took its responsibility in line with quasi-Western liberalism according to which 'the task of the state begins where the activity of private enterprise ends' (Hershlag, 1988, p.2).

The implementation of this policy, as drawn up in the Congress, followed soon. During the 1920s, the Kemalist development strategy was totally in tune with free enterprise and the major pieces of economic legislation were designed to encourage private enterprise (Berberoglu, 1982). For example, *Is Bankasi* (The Business Bank) was established in 1924. There were two basic aims for setting up the Is Bankasi. First, it was going to be a model for future capitalist development. Second, and more importantly, the Bank was an instrument in encouraging the expansion of native industry and it was a funding source for setting up many new businesses in the country. The government set up two more banks; *Sanayi ve Maadin Bankasi* (The Industrial and Mineral Bank), to finance and manage state-owned industrial establishments and ventures; and *Ziraat Bankasi* (The Agriculture Bank), to provide credit and technical assistance to the agriculture sector and the country's farmers (Mehmet, 1983). By doing so, it was expected that capital accumulation would

expand in the hands of Turkish industrialists in the cities and the same capital would transform the countryside into modern, mechanised and productive agriculture.

Apart from the direct role played by the state through encouraging the expansion of national industry, the state tried to promote industrialisation by granting important concessions to private capital too. For instance, the Turkish government passed two important laws through the Parliament; the Law for the Encouragement of Industry in 1927, and the Foreign Trade Regulation Law in 1929. In particular, the first one was very important to encourage industrialisation through private capital because it was designed to make the private sector's investment initiatives easy and advantageous by providing several incentives such as tax concessions, easy credit, monopoly privileges (Berberoglu, 1982; Mehmet, 1983; Ceylan and Vergiliel, 1989).

It could be argued that this Kemalist development programme for economic reconstruction provided room for both the state and the private enterprise. Public enterprise was not intended to replace private enterprise; instead, both were existing in harmony within a model of so called "mixed economy". But at the end of the trial period, the Turkish middle class (bourgeoisie) failed to achieve the rapid industrialisation as expected by the government, despite the above outlined advantages provided by the state to private enterprise. The number of enterprises supported by the state increased from 470 in 1927 to 1,473 in 1933 (Berberoglu, 1982, p.27). But most of these enterprises were on too small a scale to undertake large projects which were needed for the country's industrialisation.

However, the actual policies of the 1920s which were based on private property and free enterprise as the basic principles of the state were quite promising. According to Hershlag's work, the government gradually reduced its budget deficits and even registered a small surplus in 1928-1929 largely due to the controlled

expenditure and improvements in tax collection (1988, p.4). Only the Depression years of 1929-1930 caused a budget deficit again. As can be seen in Table 2.1 below, foreign trade deficits were kept in line with the budget, usually at a reasonable but more or less steady level.

Though only unreliable statistical data is available, the growth of the economy improved in the same years following 1923 and evidence shows that there was a real 2-3 per cent growth in terms of per capita in GDP between 1927 and 1929. In support of this, another study indicates that from 1923-25 to 1927-29 the estimated growth rate for the GDP was 7.5 per cent. Again in the period between 1923 and 1925, the share of manufacturing constituted about 10 per cent of the total GDP (Hansen, 1991, p.316-17).

Nevertheless, despite some achievements in this early period, the general opinion was that there was a need for higher growth, a stronger and more viable economy for the country. Those enterprises which were set up or developed in the period of 1923-1929, were too small, too weak and incapacitated in relation to the industrialisation process of the country. Furthermore, the failure of the free enterprise ideology coincided with the Great Depression in the West. The negative impact of the Depression on the structure of the Soviet economy seemed to be insignificant. To the contrary, there was a major progress in the Soviet economy in line with the First Five Year Plan started in 1928. All these developments were convincing enough for the Kemalist bureaucrats to take decisive steps in moving the state to the forefront of the national economy. Accordingly, the state began to assume an even greater role and responsibility by taking steps for complete control over the national economy- namely capturing 'the commanding heights of the economy'[1]- at the end of 1920s and during

[1] The ideology of 'commanding heights' appeared differently from one country to another. For French planners, for example, the six sectors (coal, electricity, steel, cement, agricultural machinery, and

the 1930s. Thus, Turkey entered a unique period of capitalist development which was later to be called "etatism", and this period also marked the beginning of consolidation of state capitalism in Turkey.

2.2 The concept of "Etatism"

Historically the main reason why the state has taken a prominent role in development has been the different timing of capitalist development among nations. The lag between early and late comers to the industrial revolutions caused the state to formulate policies to cover situations in which the private sector had not delivered according to expectations. Other reasons why the state could be helpful in development are its capacity to discriminate and internalise the difference between private and social net benefits; its access to better and more costly information; its power to undertake greater risks over longer periods of time; its potential to mobilise higher levels of savings, given incipient development of capital markets; and its ability to elaborate and rank policies to fight inequalities and promote social welfare.

The defence of active and far-ranging state policies was paralleled by the emergence of the Keynesian welfare state and the development of a vast array of macroeconomic concepts and tools. The vast acceptance of public intervention resulted in overindulgence in the growth of large, bureaucratic state bodies. The cost was to discourage the creative energies of many individual agents and waste productive resources.

If critics were correct in pointing out deficiencies, however, state development policies accomplished some positive results: Japan's economic prosperity and Korea's advancement in industrialisation were the result of successful alliances between

transportation) were targeted in the first plan from 1946 to 1953 to capture, while the commanding heights for Britain were fuel, power generating and transport industries (Maunder, 1979, p.135&191; Delorme, 1992, p.25).

planning and private sector management. Brazil's higher than average rate of growth in the half-century before 1980s is also an example of the use of policies to expedite growth, although there may be costs that were not fully recognised at the time.

Although most governments currently display a general commitment to free trade and to more liberalism, they define and practice the market in different ways. The overwhelming weight of informal norms in Japan, the characteristics of organised capitalism in Germany in the "social market economy", from "sozial partnerschaft" in Austria, to the "negotiated economy" in Scandinavian countries, the mixed economy in France, and the pervasiveness of local alliances in Italy are examples of such practices in otherwise market economies (Delorme, 1992, p.26).

If one examines the question of public economic intervention and development from an institutional viewpoint it will be found that economic intervention by the state varies from one country to another, but it will be also noticeable that planning, both on micro and macro level and usually in an indicative form, is employed as one of the main tools of economic intervention. This has certainly been the case for the French state.

After the Liberation, nationalisations and the design of national planning were used in France. The concept of etatism (*étatisme* in French) was employed as an ideal-type often used to refer to several putative features of the relationship between French society and the state (Hall, 1986). As Hall notes, in the literature on France, etatism has been heavily identified with planning, and that was entirely appropriate in the early years of planning. France started to document her needs with the First Plan by concentrating on the basic needs of coal, steel, electricity, cement, transport and agricultural machinery for her devastated economy during the Second World War. Succeeding plans gradually became more ambitious and complex but at the same time

French planning kept its 'indicative' form by providing financial and other incentives to the firms which complied with the provisions of planning. The significant role played by government in the management of the economy has distinguished France from the other Western industrial societies. This fits Estrin and Holmes's (1983) view that 'French Planning is becoming a framework for medium-term government economic policy'.

Even though planning and economic intervention are particularly associated with France they are to be found in many other countries. Government of other countries also intervened in their economies in particular during the 1930s and the post-war period. In Britain, for example, one form of indicative planning was tried in the 1960s. This policy change was government's response to the basic problems of the British economy such as payment deficits, rising unemployment, inflation and low industrial productivity (Young and Lowe, 1974, p.174).

However, in the Turkish case the concept of etatism emerged as early as the 1930s as a notion which symbolises the process of economic development of the country but also the relationship between Turkish society and the state. Therefore, it may be important to examine the argument about etatism by assessing the notion from different angles such as its origins, reasons for etatism, principles of etatism and ideological basis, if there is any, of *etatism* in the Turkish context. This will lead us to the following sections in which the implementation of etatism and its consequences from the 1930s and onwards is discussed.

The government of Turkey began to set up and operate different types of economic enterprises in the early 1930s. This policy and measures related to this new transition became known as "Etatism" (*Devletçilik* in Turkish). The concept of etatism, not surprisingly, was variously interpreted and opinions on etatism are

different from one author to another in the Turkish context. Thus, it is very difficult and doubtful whether a satisfactory definition of the notion can be given because the character of the notion is mostly to be defined by the way in which etatism is applied. Among the various descriptions, etatism was defined as 'a modernized form of mercantilism', 'an advanced type of socialism' or 'mild socialism', or regarded by some Turks as 'a third way outside capitalism and socialism but a unique mixture of the two', and 'a poorly managed capitalist economy' controlled by the government (Hale, 1981, p.55; Leeds, 1988, p.152; Kepenek, 1990, p.29). Bugra also notes ambiguities in relation to the definition of the etatism among the Republican People's Party (RPP) members. Certain members of the Party used the term "state socialism" with reference to the economic regime of the country while "socialism of an advanced type" was the description of etatism by another group within the Party (1994, p.108).

Indeed, at the beginning, Atatürk and his deputies clearly pointed out that etatism was neither derived from some ideological dogma nor was it intended to eliminate private enterprise. In 1932 Atatürk, for example, expresses this point as well as the principle of etatism as follows:

> The principle of Etatism that we have chosen to follow is not in any way the same as in Collectivism or in Communism which aims at removing all instruments of production and distribution from individuals, thus organising society on a completely different basis and leaving no room for private and individual enterprise and action in the economic field. The end of Etatist policy, while it recognises private initiative and action as the main basis of the economy, is to bring the Nation in the shortest time possible to an adequate level of prosperity and material welfare, and in order to achieve this, to ask the State to concern itself with those affairs where this is required by the high interests of the Nation, especially in the economic field (cited in Okyar, 1965, p.101).

So, in those days, from the economic policy makers' point of view, the main justification of the state involvement, usually through SEEs, in the economic field was that it would provide a short-cut to industrialisation and a stimulus to the economy.

Just three years later, in 1935, the RPP's manifesto reaffirmed this policy and defined etatism with the following words:

> Although considering private work and activity a basic idea, it is one of our main principles to interest the State actively in matters where the general and vital interests of nation are in question, especially in the economic field, in order to lead the nation and the country to prosperity in as short a time as possible (cited in Mehmet, 1983, p.52).

Therefore, it seems that pragmatic and practical considerations were more influential than any doctrinaire motive in the adoption of etatism. Furthermore, in theory, etatism was a development strategy intended not to eliminate private enterprise but simply to initiate and develop necessary projects in fields which were of vital concern to the prosperity and strength of the nation, and in which private capital was inadequate. The state justified its intervention in the economy by removing this insufficiency and quickening the achievement of the maximum rate of economic development (Karluk, 1994, p.17).

Again, going back and referring to Atatürk's definition of etatism, later in 1935 he explains and indicates this failure as follows:

> Turkish etatism is not a system which borrows ideas that have constantly been harped on by socialist theoreticians in the 19th century; it is a system peculiar to Turkey which has evolved from the principle of the private activity of the individual, but places on the State responsibility for the national economy, with consideration of the needs of a great nation and large economy, and of many other things that have not been done so far. ... This road which we have followed is, as we have seen, a system different from liberalism (cited in Hershlag, 1968, p.71).

In the same party speech, Atatürk also mentioned that since things have to be done quickly, it must be 'a system different from liberalism'. Thus, despite the difficulty of understanding the precise character of etatism from Atatürk's definition, it is clear that it was a perception of necessity, not an ideological idea or reason, that led to the birth of etatism in Turkey. One of the foreign authors, Bernard Lewis who

has studied the subject, gave probably the most acceptable definition of Turkish etatism. Lewis defines the term like this:

> Etatisme means the emergence of the state as a pioneer and director of industrial activity, in the interest of national development and national defence, in a country where private enterprise and capital were too weak to do anything effective (cited in Hershlag, 1968, p.73).

However, the end of 1920s was marked by two developments which were probably instrumental in an unexpectedly radical modification of the economic policy environment and state's role within the economy. One of these developments was the world crisis. Perhaps more important than the direct impact of the Great Depression on Turkish economy was the intense questioning of the viability of the market system brought along by the crisis. Thus, given the general economic and political environment of the early 1930s, etatism with its substantial degree of interventionism became the official economic policy of Turkey without much questioning. The examination of etatism shows that there were a number of main factors which influenced the origins of this policy.

The *first* and probably the most important reason was the failure of the free market economy in the 1920s. Despite the extensive efforts of the state to assist the development of Turkish industry and agriculture during the 1920s, capitalist development failed to achieve the results envisaged. The Turkish state tried to elevate the country to a developed capitalist nation with a competitive edge in the world market for industrial goods. Etatism thus appeared as a policy orientation even before the advent of the world crisis. The above stated objectives were to be attained by interventionist measures, and it was explicitly stated that the private sector could not be entrusted with the task of leading a smooth process of development. The Law for the Protection of Turkish Currency adopted in early 1930 presents an important benchmark in this respect. This was first adopted for a temporary period of five years,

but remained in application until the 1980s as a government policy tool of crucial significance. Characterised by its extremely ambiguous text, the Law assigned the government the responsibility of assuring the stability of the exchange rate, but the nature of the measures the government could take to fulfil the task was not stated. This ambiguity gave the opportunity to successive Turkish governments to liberally define the boundaries of the domain of intervention through various bylaws adopted according to the requirements of the day (Ceylan and Vergiliel, 1989, p.16).

The *second* factor was the impact of the 1929 World Depression which affected Turkey heavily and had a shattering effect on the Turkish economy, in particular on the country's foreign trade (Okyar, 1965; Hershlag, 1968). At this time, the main Turkish export items were mainly agricultural products such as wheat, cotton and dried fruits. But after the Depression, the prices of export goods and agricultural products fell very sharply, generating a big decrease in purchasing power and creating balance of payment problems for the country. Turkey instantly reacted to the Depression by curtailing its foreign trade and cutting government expenditure. Taxes were also heavily increased in the early 1930s (Okyar, 1965). Perhaps, the most significant impact of the Depression was that Turkey had to revise its economic policy. It was thought that if foreign trade could not provide the means for obtaining essential manufactured goods, then, these essential requirements needed to be provided through other means. The economic management of the country turned its attention to internal resources and internal efforts. But the question was who could provide the internal resources, and enterprise. It was obvious that private enterprise was already weak and inadequate for this task. Thus, the only way for realising the task was to turn to state initiative to take a role in investment and production in the economy.

The World Depression also had an influence on the policy change of the Turkish economy in another way. During the Depression years, not only the Turkish government but also Western governments started to question their liberal oriented economic policies (Kepenek, 1990). The economic system was undergoing a crisis and there was a need for a more rational and planned allocation of economic resources. Since private enterprise appeared to have failed, or perhaps was unwilling to play its part, the necessity for state intervention arose by undermining confidence in liberal economic policies which had been dominant until then. Thus the place which was allocated to private enterprise to fill had to be taken by the state.

Turkish leaders realised that the level of economic development they required could not be achieved only through private enterprise in the country. Therefore, models for economic development strategies should be sought elsewhere. Fascist Italy was the *third* source of inspiration with its tendency for a corporate state (Okyar, 1965; Kepenek, 1990). The Italians claimed that Kemalism was a copy of their brand of fascism. The Kemalists strongly denied this claim and they suggested that Fascism was a movement whose aim was to save a quasi-capitalist Italy from the contradictions of capitalism and from domestic anarchy born out of these contradictions. They further noted that with corporatism, Fascist Italy was trying to defuse class contradictions instead of finding a permanent solution for them. The Kemalists saw Fascism as a suitable system only for semi-capitalist societies and it was no good using it in societies which were either fully capitalist or pre-capitalist like Turkey (Ahmad, 1993; Keyder, 1987).

Despite the official hostility of the Turkish government to Fascist Italy, the success of fascism in the 1930s had an influence on a group within the RPP.[2] This

[2] For a broader discussion of fascism and its application in Turkey of the 1930s see Keyder (1987) *State and Class in Turkey*, pp.108-9.

influence was reflected in the desire to establish state instead of liberal capitalism and to attack liberalism openly. At some point, Atatürk had to intervene personally in the intra-party conflict by positioning himself against the radicals within the RPP.

However, the most important reason for Ankara's rejection of Rome's thesis on Kemalism was foreign policy considerations. Italian ambitions in the region alarmed Turkey. This can be understood by remembering the Italian occupation of south-western part of Turkey and Italian occupation of the Dodecanese following the World War I until 1922. Fascist Italy's claims to ideological hegemony were seen in Ankara as an attempt to establish her moral superiority over Kemalist Turkey before launching the real offensive. Furthermore, in 1933 and 1934, Mussolini claimed that Italy's historic mission lay in Asia and Africa, and this made Italy the principal factor in Turkey's foreign policy and forced Ankara to take active measures to meet this threat by diversifying its diplomatic relations (Ahmad, 1993).

The *fourth* source of inspiration for the origins of etatism and economic development was the influence of the Soviet Union, where heavy industrialisation through five-year plans started in 1927, was under way. Republican Turkey politically had little sympathy for the Soviet Union or its ideology of "bolshevism", but in economic matters Turkey was willing to pick up and choose from the experience of this country without ideological lenses (IBRD, 1951; Okyar, 1965). Furthermore, the Soviet Union was promising assistance in the form of credits for capital goods and technicians. A Soviet group visited Turkey in 1931 and drew up a report on the industrialisation of Turkey. According to this report, submitted to the Turkish government in 1932, the Russians recommended Turkey to invest in the fields of iron, steel, textiles and chemicals. In support of these recommendations, Turkey was granted by the Soviet Union an interest free loan equivalent to $8 million for twenty

years. This loan made effective two years later and took the form of machinery and equipment at the choice of the Turkish government. In return, Turkey was to repay the loan by her own exports to the Soviet Union (Okyar, 1965, p.99; Hershlag, 1968, p.64; Berberoglu, 1982, p.38). Though Soviet financial and technical assistance was granted to Turkey, it is clear that the Turkish government did not embrace Marxist-Leninist philosophy, or the goals and instruments of the communist state such as collectivisation and a proletarian culture.

Finally, the *fifth* factor that needs to be mentioned was the ideological features of etatism. The core of the etatist policy, the Kemalist ideology, had its intellectual roots in European liberalism and positivism in particular from the works of Auguste Comte and Emile Durkheim through some of the Turkish intellectuals or philosophers (Kahveci, 1995). That is to say that Kemalism can be described as more than Atatürk's own ideas. It was shaped by intellectuals before and after Atatürk. Ziya Gökalp, who was a Turkish nationalist, for example, influenced the nationalist economic reconstruction programme in the country. Gökalp firmly believed in a national economy as a necessary condition for the viability of the Turkish state (Mehmet, 1983; Hershlag, 1988). He rejected Ricardo's free trade theory of comparative advantage by dismissing it as "nothing but the national economics of Britain". Instead he relied on the protectionist theories of Frederich List (Mehmet, 1983, p.51). Later in Turkey, Gökalp's ideas about economic nationalism found a strong disciple, Ismet Inönü, who was Atatürk's right-hand man and his successor, as we shall discuss below.

Another ideological influence came from the Kadro movement. Some influential ideologues gathered around a monthly magazine called *Kadro* (Cadre). This was the most radical wing of Kemalism and some ex-Marxist intellectuals had a

strong presence. Kadro took as one of its aims the creation of an ideology original to the regime. In seeking this original ideology, the Kadro movement actively tried to propose policies to the government. Very briefly, Kadro suggested that the reform movement which started with the establishment of the Republic, had not yet finished. Turkey had to continue to change by pursuing more reforms. In order to carry out these reforms, a group or a small élite (*kadro*) should be trained. The view of Kadro group was more radical than the first one above. Its advocates implied that there might be areas in which public enterprise would be more desirable than private sector activity regardless of the desire and the ability of the latter to enter into the areas in question. Certain strategically important fields of economic activity should, thus, be left to the state. Furthermore, according to this view, the scope of public sector activity could be expanded according to national goals. Certain leading figures of the Republican Party such as Mr. Inönü and Mr. Peker, endorsed this approach as well as the editors of *Kadro* magazine (Ahmad, 1993; Türkes, 1993; Kepenek, 1990; Okyar, 1965).

More importantly, this ideology suggested that the idea of economic planning should be applied to all fields of Turkish life constituting economic, social, health and education policies. Further, such planning should be comprehensive, wholesale planning embracing the totality of each field where it was applied. However, it seems that the Turkish government did not follow the ideas of Kadro. Rather the first current of ideology (i.e. Gökalp's nationalist economic policy) had more dominance in the policy making process in the early 1930s. If the government had taken up the ideas suggested by Kadro, the whole basis of Turkish economic life would have been changed. For instance, private enterprise would have been abandoned as the main form of economic activity in favour of a socialist planned pattern of activity. But it is

quite clear from Atatürk's and other leaders' speeches quoted above that the intention was definitely not setting up such a system.

To sum up, while the developed countries were discussing whether the state had the right to intervene in economic life and to plan the future of national economies, the Turkish political system and its leaders assumed that there was a leading economic role for the state, an assumption which to some extent remained in force until 1980. Thus, in the following sections of this chapter, it will be examined how the economic development strategy of etatism were built up in the Turkish economic system.

2.3 Building up the Etatist economy (1930-1950)

Officially, etatism was launched in Turkey in 1933. The establishment of *Sümerbank*, a combined state bank and national holding company, marked the occasion. The Sümerbank was set up for financing, construction and operation of different fields such as textiles (cotton and woollen), steel, paper, rayon, ceramics and cement plants (Okyar, 1965). In the meantime, five-year economic planning started to be implemented with Russian economic and technical assistance in 1933 as mentioned above. Broadly, the First Five Year Plan covering 1934-1939 aimed to construct twenty factories in different fields of the economy all around the country. At the end of the five year term, most of the targets drawn upon in the Plan were realised (Berberoglu, 1982). In 1934, *Etibank* was established in order to take care of mining such as coal, sulphur, copper, chrome and iron ore. By law, both banks as well as state owned enterprises, were granted to have subsidiary units which will produce needed goods and services. Moreover these state companies were kept outside the law governing the spending of public funds and covering the expenditure of all departments under the general budget. They initially operated under private commercial law.

With these first investments, the decision of the Turkish state to take a direct role in 'industrialisation or modernisation' of the country started. In other words, the state started to play a central role in the industrialisation and capital accumulation process by replacing the small, weak and incapacitated national industrial bourgeoisie's role with its economic institutions.

The following period witnessed the vigorous implementation of etatism through waves of SEEs which were built as state monopolies and financed by subsidies and credits were provided with low interest from the state. This was the right environment for SEEs in Turkey to mushroom in every sector of the economy including in railways, shipping, heavy industry, physical infrastructure, banking, mining, manufacturing, agriculture, tourism, services and so on (Hale, 1981).

A nationalisation campaign which was carried out in the 1930s and 1940s also helped to increase the number of SEEs. Turkish government launched an extensive campaign of nationalisation of foreign companies. Inönü, then Prime Minister, justified economic policies including nationalisation in an article in Kadro as follows:

> seven or eight years ago the struggle centred on the question as to whether nationalisation provides the means for economic protection; but more recently such polemics have become meaningless since the question has largely solved itself. The wealthier and stronger countries are trying to protect and save their economies by means which would have been unthinkable in the past (cited in Hershlag, 1968, p.70-71).

In the first part of the nationalisation programme in the early 1930s, the state took over the main railways, utilities, transportation and port facilities. The nationalisation of many mines and factories largely owned by foreign capital followed this in the late 1930s and early 1940s (Berberoglu, 1982; Ceylan and Vergiliel, 1989, p.16-18). The impact of nationalisation on Turkish economy was quite positive in terms of strengthening the economy. Nationalisation not only improved Turkey's

balance of payments by stopping the outflow of capital but it also led the further state expansion into different branches of the economy.

After 1936 and especially following Atatürk's death in 1938, etatism became increasingly rigid and took a doctrinaire form by discouraging private enterprise and justifying the proliferation of state monopolies. This also somehow had an indirect impetus behind the nationalisation process. Indeed, with the great influence of Inönü, the principle of etatism became a state dogma by entering into the constitution in 1937 and it was then adopted as the ideology of the RPP as a part of the country's political regime (Ceylan and Vergiliel, 1989, p.18).[3] In fact, this was the time when the degeneracy of etatism started. On the one hand, the clear threat of Fascist Italy over Kemalist Turkey as mentioned earlier, and on the other the growing influence of Nazi Germany in Turkey in the late 1930s, gave Inönü an opportunity to defend and setup economic nationalism and authoritarianism. Etatism, for Inönü, was a matter of necessity justified on grounds of national security and survival. He expressed that as "the policy of economic etatism, above all, by being a policy of defence, appears to be necessity in itself" (cited in IBRD, 1951, p.7).

It is possible to describe Inönü's world-view as autarkic. His aim was a self-reliant economy freed from external dependence on finance and trade. He did not trust foreign bankers and financiers. In this context, Inönü considered self-sufficiency as a matter of national security and justified heavy investments in railroads and infrastructure on the basis of his popular slogan "three whites and three blacks" (Mehmet, 1983, p.54 & 64). That is self-sufficiency in flour, sugar and cotton textiles, and in coal, iron and petroleum. By pursuing this ideology, the Turkish economy

[3] The two Turkish constitutions as of 1937 and 1961 both stressed *social state* as one of the principal characteristics of the Turkish Republic. The term 'etatism' was used to help justify large-scale governmental intervention in economic and social life in order to guarantee social justice, equity, and social peace.

became essentially a 'closed economy' framework or 'inward oriented' economy in accordance with the self-sufficiency principle. Foreign investment and trade were discouraged in favour of the creation of a domestic market owned and operated by the Turks themselves.

Within the framework of etatism from 1933 to 1950, Turkey set its industrialisation goals. These goals were rapid development through an increase in physical production, mainly in industry; improvement in the balance of payments; raising living standards through economic growth and agrarian and social reforms; and economic independence and reliance on domestic resources. In order to achieve these objectives, the policy of etatism, more or less imposed from above was not a spontaneous form of policy or a product which came up from within the society, but was implemented with the elements of five year plans, economic legislation, state banks and state economic enterprises and nationalisation of foreign enterprises.

Before assessing the macro economic results of Turkish economy within the given period, I would like to point out the difficulties I had to face. Firstly it was rather difficult to find statistical data especially prior to the 1930s. Even though I was able to get some, the available data was quite confusing to analyse due to different estimation techniques used by different authors, or the data did not seem very reliable in its origin. Therefore this ambiguity may have led to some contradictory results in this part of the thesis. Thus I have avoided drawing a general and unqualified picture of the Turkish economic situation with regard to this early phase of etatism. Instead I preferred to present the perspectives of various authors without much attempt at interpretation.

In Turkey, as the consequence of the planning and development policies of the 1930s, GNP began to increase, in particular from the mid-1930s, and a 4 per cent real

growth in terms of per capita followed this. At the same time the balance of payments on current account improved in the years between 1933-1949. For instance, from 1933 to 1949 each annual budget had a surplus, except for the budgets of 1939 and 1944 (Birtek, 1985, p.412; Hershlag, 1988, p.14-15). The characteristics of an inward oriented economy based on domestic products and restrictions on some imported goods helped to create balance of payments surpluses. As the figures in Table 2.1 shows, the Turkish foreign trade balance took a sharp turn for the better (mostly in response to the world crisis) and it began to register a surplus starting in 1930 throughout the decade and into the 1940s, except in 1938. This trade surplus helped to increase Turkey's foreign exchange earnings as well as improving its balance of payments considerably.

Table 2.1: Turkish Foreign Trade 1923-1945 ('000$)

Year	Import	Export	Trade Balance
1923	86.8	50.7	(36.0)
1925	128.9	102.7	(26.2)
1927	107.7	80.7	(27.0)
1929	123.5	74.8	(48.7)
1930	69.5	71.3	1.8
1932	40.7	47.9	7.2
1934	68.7	73.0	4.2
1936	73.6	93.6	20.0
1938	118.8	115.0	(3.8)
1940	53.0	85.7	32.7
1942	113.6	129.9	13.3
1944	126.8	178.9	52.0
1945	97.0	168.4	96.1

Note: ( ) indicates a deficit in foreign trade.
Source: Berberoglu (1982, p.48); SIS (1996) *Statistical Indicators, 1923-1995*.

It is argued that the creation of balance of payments surpluses helped the economy in three ways. First, it held prices steady until World War II hence benefiting the classes with fixed incomes. Second, it helped the currency maintain its parity with international currencies, thus easing the repayment of the Ottoman debt

and the importation of industrial equipment. Third, the government was able to finance its industrial investment without increasing taxes and using the earnings of the SEEs.

Hershlag estimates in his earlier work that Turkey's income per capita increased by 19 per cent in constant prices during the decade from 1929 to 1939, about 1.7 per cent annually (Hershlag, 1968, p.121). Similar to those results, Land's estimation shows that there was an average annual growth of income for 3 per cent between the period of 1933-1948. But this growth rate slowed down to 2 per cent annually between 1939 to 1948 due to the stagnation and harsh conditions of the War years (cited in Krueger, 1974, p.6). Table 2.2 below shows clearly that the share of industry increased while agricultural production practically remains much the same in years between 1929 to 1946. There was more than a 50 per cent increase in industrial output during 1935-1946 but agricultural output does not show any significant increase, and national income also looks to be declining in terms of per capita.

Table 2.2: Turkish Production and Real National Income Indices, 1929-1946

Year	Agricultural Production	Industrial Production	National Income	National income per capita
1929	73	57	72	85
1935	72	82	83	87
1938	100	100	100	100
1939	105	114	104	101
1940	106	124	n.a.	n.a.
1942	103	112	n.a.	n.a.
1944	86	126	91	83
1945	74	128	86	78
1946	94	130	n.a.	n.a.

Note: Based on 1938 figures (1938=100); n.a.= not available.
Source: Mehmet (1983, p.53)

According to Hershlag (1988), the aggregate rate of growth in the agricultural sector did not register any substantial increase due to, primarily, fluctuations in crops

and lack of investment or ignorance in this sector. Moreover, he estimates that there was about 2 per cent growth rate annually in agriculture while the same rate was an average of 10 per cent per annum in industry. He adds that the share of industry in the national economic output increased from 14 per cent in 1929 to 19 per cent in 1939.

When one attempts to draw a conclusion about the etatist policy of 1930s and 1940s and its results, one has to confront contrary opinions in the literature. One group of authors, generally, support etatism and its implications while others oppose this on the ground that etatism did not accelerate the rate of aggregate economic growth and national prosperity as expected. They put forward their argument by indicating the negative effects of etatism in the early phase. For example, reviewing the industrialisation strategy under the first and second five year plans, Krueger (1974) has estimated that under a more labour-intensive and export-oriented alternative strategy, at identical levels of investment, the Turkish economy could have done substantially better, realising a total of over 300,000 additional jobs, lower imports, and higher output. Another team of foreign experts, knowing little about the historical constraints of the Turkish case, dismissed the national development strategy of etatism. They argued that etatism had 'deliberately discouraged' private enterprise which was 'hardly given a fair trial' (Thornburg *et al.*, cited in Mehmet, 1990, p.133).

Besides lack of economic success, Mehmet (1983) mentions that etatism perpetuated a collective psychology of state paternalism. That resulted in looking up to the government by expecting all the problems to be solved by the state which was a legacy inherited from the days of the all-powerful Ottoman sultan. This point of criticism was, in fact, taken into consideration by Atatürk at a party conference in 1931. Atatürk justified this legacy with the following words:

> Our people are naturally etatist because they see it as their right to demand from the state all sorts of remedies to their problems (cited in Leeds, 1988, p.152).

However, Mehmet concludes that:

> etatism in fact brought about a noncompetitive, closed economy dominated by state monopolies that were badly managed and increasingly overstaffed (1983, p.53).

A softer approach is taken towards etatism by other authors. For example, cost aside, a World Bank study indicates that Turkey indeed made 'substantial progress' in this early period of etatism. The World Bank judges its observation as follow:

> Under etatism Turkey has made substantial progress. It is doubtful if comparable accomplishment would have taken place in this period under domestic private enterprise with the handicap of the Ottoman heritage (cited in IBRD, 1951, p.9).

In accordance with this last judgement, Okyar (1965) believes that the advantages and benefits of etatism, both visible and invisible such as external economies, training of manpower, have far outweighed the disadvantages. Even though he is not in the favour of etatism as a viable and stable economic system at all, Okyar concludes that "Turkey would be generally well behind where she is to-day if Etatism had never been introduced" (p.103). One might point out that etatism was perhaps necessary in the first stage of industrialisation, but became a burden later.

Etatism which implies widespread government intervention in economic life, remained the underlying economic ideology up until the 1950s, even creating stricter government controls on the allocation of the country's resources in the face of dire circumstances of the Second World War years. Simultaneously, political and economic conditions kept changing in Turkey alongside the post-war economic and political development in the world. Moreover, internal and external political developments made it necessary for Turkey to adopt a multi-party system in the post-war period.

Both urban and rural groups favouring a more liberal approach in the management of the country were slowly gaining strength as resentment to the

authoritarian leadership and low wages in the industrialist-bureaucrat dominated economy grew. One the one hand, the rural majority were not satisfied with the state's economic policy in agriculture because the policy failed to generate any significant benefit for those in the agricultural sector and it also led to a reduction in agricultural export incomes due to an over-valued lira. On the other hand, support for the RPP was further eroded by the authoritarian government's harsh war-time policies which led to an increase of four-fold in consumer prices compared to incomes. Severe austerity measures implemented during the war years caused a rising anger among the large segments of the society, in particular, among urban populations with fixed incomes. To a certain extent unable to feed or defend itself, Turkey received aid from Britain, France and the USA. This further discredited the ideas of national self-sufficiency with which the RPP was closely associated.

Resentment against the RPP's interventions in both economic and social life was high, as were pressures for market reforms from both urban and rural groups. These internal forces, together with American pressure for Turkey to adopt more liberal political and economic policies as evidence of its worthiness to receive technical, military, and financial aid induced the RPP to permit the formation of an opposition party in advance of the 1946 elections. The new party quickly gained support. Consequently, the Democrat Party came to power in 1950 by defeating the RPP, the party of Atatürk, which held power in the country for 27 years.

2.4 The Revival of 'Liberalism' in the 1950s

In 1950, the Democrat Party (DP) won the general elections on a platform of full support for private enterprise. The leader of the DP, Adnan Menderes, carried out his election campaign on the basis of promises of re-installing economic liberalism and promoting free enterprise in the country. During the election campaign, the DP

exploited the public's memory of past grievances. They kept reminding people that nothing could really change while the RPP and its leader Inönü remained in power. This propaganda proved to be effective due to the fact Inönü became to symbolise the hated single party regime especially during the War years. The Democrats also cleverly first neutralised the bureaucracy and then they won the support of bureaucrats by blaming the RPP for the problems of the country not the bureaucracy. Once the Turkish public saw officials, which traditionally have great influence on ordinary people, on the DP side, voters decided to put an end on 27 years of Republican rule. Actually, it seems that the decade of the 1950s was the appropriate time for such changes as happened in many other countries such as Japan, South Korea, Taiwan, Hong Kong after the War.

Obviously, implementing such an economic policy requires promotion of the private sector by gradually privatising the SEEs, offering appropriate incentives to investors and undertaking monetary and trade reforms to develop a competitive, export-oriented economy. Thanks to significant amounts of foreign assistance, particularly from the US, and a small amount of foreign investment made in the early 1950s, the Democrats worked along these lines in order to turn the country into "a little America within thirty years" (Hale, 1981, p.88) and create "a millionaire in each neighbourhood" (Bugra, 1994, p.121).

The new government seemed quite determined to transfer SEEs to the private sector, and by doing so they believed that this would bring back the 'liberal' economic policies of the 1920s. In line with this strategy, many SEEs were offered for sale. As Berberoglu notes:

> Under the guise of 'encouraging the national industry', their services, raw materials, power plants, and transportation facilities were offered to private entrepreneurs at less than the market price. The skilled personnel trained in state enterprises began to transfer to the private sector (1982, p.67).

What happened, in reality, was that in spite of certain inefficient efforts, few state factories were sold to the public. The lack of success of the attempts at privatisation was both due to the lack of a capital market and weakness of the private sector. But perhaps the most important reason was that of producing more to meet the increasing effective demand which was mainly due to the monetary expansion of capital, which had a greater priority for the Menderes government than leaving production to the private sector and facing some risks. Also the private sector was seemingly hesitant to take the place of the state rather than enjoying the benefits, that is cheap inputs provided by the SEEs. Soon the government gave up its programme completely and the balance between public and private sectors remained relatively unchanged until the mid-1950s as shall be discussed below. Furthermore, the DP immediately abandoned economic planning as a step towards more liberal economic policy. Menderes argued that 'the budget is the Plan' whilst his finance minister expressed the official distaste of government for planning by saying "Let's get on with the job: the plan can follow on later" (cited in Hale, 1981, p.88).

The overall economic situation in the early 1950s was not too bad. An impressive agricultural output was recorded. This was due to the two reasons; a combination of good weather and dramatic gains in labour productivity which originated from imported farm technology based on tractors. In 1948 there were 1,750 tractors in Turkish agriculture whilst in 1953 this figure was multiplied 20 times to 35,000 tractors. Moreover, in the period of 1933-40 investment in agriculture was about 10 per cent of total investment and after 1950 this figure also rose to 22 per cent. But this was a highly capital-intensive technology which generated a huge labour surplus (Birtek, 1985, p.435; Krueger, 1974). The Democrats' agricultural strategy was uneven; because, on the one hand, this strategy initiated mechanisation of

traditional agriculture to boost output, but on the other hand, it did not adopt a labour-intensive strategy in other fields of the economy to absorb surplus labour. It could be argued that with the control of SEEs the DP government was able to solve the emerging unemployment problem to a certain extent for a short time but almost nothing was done by the government to create significant alternative employment opportunities in either rural areas or around the big cities. This labour surplus later on was going to cause some social problems such as social unrest and inequalities, labour migration to the big cities from the rural areas and its consequences.

Table 2.3: Sectoral Shares in GNP (%), 1950-1990 (at constant prices)

Years	Agriculture	Industry	Services
1950	41	13	46
1955	38	15	48
1960	38	16	47
1965	31	19	50
1970	29	19	52
1975	23	22	55
1980	23	22	55
1985	19	24	57
1990	16	26	58

Note: 1948-1967 period at 1968 prices and 1968-1990 period at 1987 prices.
Source: SIS (1996).

As can be seen from Table 2.3, the share of agriculture in GNP fell 3 per cent in five years, from 41 per cent in 1950 to 38 per cent in 1955, and remained at the same level in 1960. Krueger (1974) notes that the decrease in agricultural production and thus its share within GNP, was mainly due to the bad weather conditions in 1953-54.

The Democrats' industrial strategy, however, was not better than that for agriculture. The emphasis upon agricultural development by the DP lost its priority around 1953. In contrast to its expressed programmes and speeches, government policy became increasingly interventionist. This policy change took the form of increased investments by SEEs in such fields as cement, sugar, fertilisers, steel and so

on (Okyar, 1965; Krueger, 1974). As the figures in Table 2.3 shows the share of the industry in GNP increased 3 per cent from 13 per cent in 1950 to 16 per cent in 1960. The number of SEEs had been widened, especially after 1953, both qualitatively and quantitatively. Turkish Cement Industry (1953), Turkish Petroleum (1954), Turkish Iron and Steel Enterprises (1955) and Turkish Coal Enterprises (1957) were some of the SEEs that were established during this period. Again, capital intensity was emphasised despite emerging excess labour pressures as noted above. Without any coherent plan or policy, factories and industries were built around the country without taking cost, efficiency or locational advantage into consideration. Only political advantage seemed to matter. Redundant sugar and cement factories built by Democrats were notorious. As Hale expressed it:

> ... examples of badly planned and located plants abounded in the 1950s. The Democrats' primary purpose was to win votes. Accordingly, they were frequently prepared to establish factories in politically sensitive areas, even if the production costs were unnecessarily high, or there was no demand for their production (1981, p.92).

In other industries, the Democrats followed the same misguided pricing and investment policies. In iron and steel, for example, they attempted to expand domestic productive capacity by building a second plant at Eregli to supplement the high-cost plant at Karabük. In textile manufacturing, despite rapid expansion of a private sector, they maintained a firm support to the textile giant, Sümerbank which kept its prices well below than its private competitors thus creating excess capacity and large operating losses.

In contrast to their own economic philosophy, the Menderes government kept on expanding the size of the public sector. In manufacturing, the SEEs accounted for 57 per cent of total fixed capital formation in 1958 compared with 54.4 per cent in 1950 (Hale, 1981, p.91). Moreover, the balance of gross domestic capital formation between private and public sectors changed from 1951 to 1960. The public sector's

share of total investment was already high, and this rate increased from 38.1 per cent in 1951 to 50 per cent in 1960, and then 55.7 per cent in 1965. Government investment was concentrated not only in infrastructure but also through the SEEs in manufacturing, mining and other fields (Krueger, 1974, p.13). The SEEs not only expanded their share within the economy but more importantly, they became objects of patronage politics. Loss-making SEEs multiplied as favouritism, featherbedding and political interference in their management became political tools.

In the decade of the 1950s, systematic mismanagement of the SEEs continued. Originally the SEEs were not expected to operate as state monopolies stifling private enterprise and depending upon subsidies. In fact, Law no. 3460 enacted in 1938, was the fundamental law regulating SEEs. It provided the possibility that SEEs would be reconstituted as joint-stock companies in which shares, either wholly or in part, could be transferred to the private sector (Okyar, 1965). They were also expected to operate as profit-making (if not profit-maximising) entities. But in practice this provision was discarded. Privileged arms-length relations with the state and protective policies turned SEEs into permanent and non-competitive state monopolies. SEEs had easy access to the loans from the Central Bank with a very low interest rate, while private borrowers had to pay 8-10 times more interest rate on commercial loans. The SEEs were not only free from domestic competition, but they were also generally isolated from international competition by protective tariffs and an over-valued Turkish lira which encouraged import substitution at the expense of exports (Krueger, 1974).

Thus it could be argued that there was a lack of the profit motive in the SEEs model. Successful management was not based on profitability. In addition to this, a law was passed regulating legal profit margins on private transactions and imposing legal ceilings on SEEs prices. Therefore, the SEEs had to ask the government to cover

up their operating-losses since they had been in the position of rising input costs and fixed output prices. In other words, it was the government policy which forced SEEs to sell below the production cost, so bureaucrats and politicians who decide pricing and investment policies of the SEEs, have to shelter SEEs' operational losses and management incompetence. Under the circumstances, loss-making SEEs multiplied with relative ease. The public sector became the centre of patronage politics dominated by featherbedding and favouritism. As losses and deficits of SEEs mounted, mismanagement had a cancerous effect on professional standards and worker morale.

In summary, the 1950s witnessed the adoption of market reforms in Turkey which caught the majority of the people unprepared at the time. The harsh reality of competitive market economics forced the DP government to bring back some of the policies of etatist era. The economic boom of the early 1950s which was based on a fragile strategy of agricultural exports and inflows of foreign aid to finance investment and consumption, turned into a bust. Despite the decreasing trend of agricultural production and income, and a decline in world agricultural prices, the populist DP leadership preferred to maintain the high consumption patterns with government spending financed by external borrowing and expanded investment in the SEE sector. Consequently, high inflation, growing unemployment and the burden of increasing taxes started to reduce the purchasing power of the masses, in particular the working class, in the late 1950s. The wholesale price index, for instance, reached 280 in 1960 from 100 in 1948 (Ceylan and Vergiliel, 1989, p.20). The worsening economic situation began to affect large segments of the society especially those living in the cities. Soon the economic crisis turned into a social and political one with mass civil

unrest, and it ended up with the military coup of May 1960 which brought the end of the Menderes decade.

2.5 The Planned Economy Experiments (1960-1980)

The decade of 1960s started with the restoration of the parliamentary democracy after the military coup against Menderes in 1960. This was also the period when the import substitution industrialisation strategy (hereafter ISI) was implemented under successive five year plans as the principal development strategy up until 1980.

After the coup, the lack of planning was regarded as the major cause of economic mismanagement under the Menderes administration (Karluk, 1994, p.22). Therefore, Professors Tinbergen and Koopman were commissioned by the new leadership of Turkey to advise on the best form of planning appropriate for the country. The result was the establishment of the State Planning Organisation (SPO). Despite the tendency of Tinbergen and Koopman to favour French-style indicative planning, the Kemalist forces in the country wanted to restore central planning, and thus the SPO emerged as a powerful instrument of etatism (Krueger, 1974). The prescription chosen was the ISI strategy based on the usual menu of protective tariffs, overvalued currency and a wide range of direct and indirect public subsidies for infant industries.

The role of the SPO in planning was frequently subject to political interference. Investment and allocation decisions were usually made by the politicians rather than the SPO technocrats (Altinok, 1982; Ceylan and Vergiliel, 1989). In the course of four Five-Year Plans between 1963-1983, the planning technocrats and politicians clashed many times. Politicians were usually on the winning side. They manipulated planning and relied on deficit financing to boost the growth rate. They employed a

highly protectionist ISI strategy. They also led the mismanagement of SEEs by protecting them from economic hardship and keeping their output prices low, and then covering their operating losses with state subsidies. These subsidies were financed partly by monetary expansion and short-term political gain and for long-term economic disaster.

The adoption of ISI policy helped the emergence of a Turkish capitalist class which was still dependent on state protection and subsidy in the 1960s. The Turkish capitalist class did not hesitate to join the centrist political, bureaucratic and military elites to set up a development policy in the country. The result was a non-competitive industrial strategy based on a mixture of private and public enterprise. On the one hand, private 'infant' industries[4] which were owned and operated by the emerging industrialists, were continuously encouraged and supported by a variety of protective policies. On the other hand, state planning and etatist intervention in the Turkish economy were restored. SEEs were not replaced by 'infant' industries in the country. Actually, little attempt had been made to privatise or denationalise them.

Furthermore the ISI strategy exacerbated the structural imbalances of the Turkish economy too. While private 'infant' industries were heavily subsidised by tariffs and other measures which amounted to effective rates of protection of up to 400 per cent or higher (Krueger, 1974), the role of the SEE sector began to change. The SEE sector started to act as supplier of underpriced inputs to private 'infant' industries. Under the weight of these indirect subsidies, the SEE operating losses increased drastically by creating a heavy fiscal burden on the national budget. The operating losses of the SEEs (mainly due to the impact of the oil shock and

[4] The intellectual justification for ISI is originally an "infant industry" argument: protectionist measures are needed while nation's industrial economy develops and can withstand competition. This usually extends the relationship between the industrialists and the state, and replaced market mechanism with rent-seeking behaviour.

mismanagement of the enterprises and economy in general) which were financed by transfers from the national budget, generated an unprecedented monetary expansion which in turn led to spiralling inflation in Turkey.

However, despite these heavy losses of SEEs, the SEEs investments continued in an increasing manner. The SEEs' investments in the total public sector investment rose 50 per cent in 1977 and 54.1 per cent in 1979 compared to 34.8 per cent in 1967 (Kepenek, 1990, p.50; TÜSIAD, 1983, p.22). At the same time, the total SEE contribution to the GDP in 1977 was a mere 7 per cent, exactly the same proportion as a decade earlier in 1967. Within such a protective environment, the size of SEEs grew. For example, during 1973-1977, employment in the SEEs increased by 52 per cent from 425,862 to 646,157 (Mehmet, 1990, p.139). Overall the state subsidies and transfers to cover the operating losses of the SEE sector was half of the total current expenditure in the national consolidated budget. This chronic mismanagement of the SEEs became the major cause of the economic crisis in which Turkey found itself in 1979-80.

Önis and Riedel (1993) argue that Turkey's macroeconomic problems were homegrown, and successive governments pushed the economy beyond stability because of political imperatives that were closely related to the needs of the broad coalition. They argue that, until the military coup in 1980,

> too often, governments in Turkey tried to build a broad coalition by promising the various political constituencies more than they could deliver, causing economic instability and, periodically, a crisis (1993, p.2).

The study of Hershlag describes the net results of state planning strategy of the 1960s and 1970s and its ramifications as:

> uneven and discontinuous growth, for the most part falling behind targets and expectations; a still backward agriculture; more surplus labour in both rural and urban areas; deficits in the public budget and on current account. The situation in the late 1970s

was an inflationary spiral with all its economic and social repercussions (cited Shaker, 1995, p.24).

Analysts of the Turkish political economy agree that etatist planning and the inward-oriented policy of import substitution seemed to be working to the satisfaction of various interest groups. In macroeconomic terms, for example, the period from 1960 to 1980 was one of rapid economic growth. Income per capita rose five-fold, the share of industry surpassed the share of agriculture, and furthermore, more than half of the GNP was created in services (Hale, 1981, p.129-131). But the rapid growth of industry under the ISI strategy was inflationary because it was financed by monetary expansion caused by deficit spending and short term foreign borrowing on highly unfavourable terms.

The delayed social costs of economic mismanagement started to appear in the early 1970s. Inflation began to emerge as an increasingly serious problem, reaching a three digit rate at the end of the 1970s. But the hardest time came with the OPEC petrol crisis in 1973. Turkey was no longer able to manage external disequilibrium after the quadrupled oil prices. This caused serious economic problems for the country, especially regarding the balance of payments. The ISI strategy was based on cheap imported oil and production of highly uncompetitive goods for the domestic market rather than foreign markets. Further, the military intervention in Cyprus by Turkish troops in 1974 worsened the economic situation and added to the fiscal burden.

As a result, the economy was crippled since most of the Turkish export goods were not good enough to compete in foreign markets and were therefore not able to bring in foreign earnings for the country's imports. In early 1978, the Turkish government was in a state of bankruptcy and had to seek financial relief from

international creditors while, on the other hand, trying to reschedule its existing foreign debts.

After long and hard negotiations with the IMF, a large standby agreement was signed in 1979 based on the usual IMF 'medicine' of deflationary stabilisation and structural adjustment. The main theme in this package was a commitment to phase out etatism in favour of economic liberalisation and an export-oriented strategy. Moreover, with this agreement, the Turkish government undertook to cut the SEE subsidies, to privatise state monopolies and public enterprises, to devalue the Turkish lira to switch to a more open, competitive and free enterprise economy, and to encourage the private sector. Thus it seemed that after more than 50 years, the ideology of etatism came to end. With the combination of different impacts but mainly with the encouragement of the World Bank and IMF, the Turkish economy made way for a new market ideology. The Turkish development strategy entered its liberalisation and privatisation phase as will be examined in the next two chapters.

2.6 Conclusion

This chapter has examined the emergence of SEEs under the ideology of etatism which was implemented in Turkey for more than 50 years between 1930 and 1980. This national economic policy aimed at opening a new era of prosperity and higher living standards for the Turkish people.

Despite some of its achievements, the trial of a free enterprise economy in the 1920s was considered unsatisfactory compared to the needs of the country for higher growth and a stronger and more viable economy. Those enterprises which were set up or developed during the liberal period of 1923-1929, were too small, too weak and incapacitated to achieve the much desired industrialisation process of Turkey.

As a result, the concept of etatism emerged in the early 1930s as a notion which symbolised the process of economic development in the Turkish case and also the relationship between Turkish society and the state. The policy makers justified the state involvement, usually through SEEs, as a short-cut to industrialisation and economic development. The official launch of etatism in Turkey began with the establishment of *Sümerbank*[5] in 1933. The policies of the 1920s which were based on private property and free enterprise as the basic principles of the state were abandoned because of their failure and the impact of the Great Depression. The Turkish state started to play a central role in the industrialisation and capital accumulation process by replacing the small, weak and incapacitated national industrial bourgeoisie's role with its economic institutions; SEEs.

Hence, the following period witnessed a vigorous implementation of etatism through waves of SEEs which were built in every field of the economy, from railways and manufacturing to agriculture and tourism. SEEs were established as state monopolies and financed by subsidies and provided credits with low interest rates from the state. The government's extensive nationalisation campaign of foreign firms in the late 1930s and 1940s increased further the number of SEEs. Even though pragmatic and practical considerations rather than any doctrinaire motive were the main reasons in the adoption of etatism, after Atatürk's death in 1938, etatism became increasingly rigid and took a doctrinaire form by discouraging private enterprise and justifying the increasing number of state monopolies. The principle of etatism became a state dogma by entering into the constitution in 1937 and it was then adopted as the ideology of the left-of-centre RPP as a part of the country's political regime.

[5] A combined state bank and national holding company.

However, the information about the results of etatism during the 1930s and 1940s is rather inconclusive due to the contrasting opinions in the literature. Some support etatism and its implications. They argue that under etatism Turkey has made substantial progress, and the benefits and advantages of etatism have far outweighed the disadvantages. Thus, Turkey would be generally well behind where she is today if etatism had never been introduced. In contrast to that, others underlined the negative effects of the etatist policies especially in the early phase. They argue that etatism deliberately discouraged private enterprise which was hardly given a fair trial. Hence, the Turkish economy could have done substantially better under a strategy based on a more labour-intensive and export-oriented approach. Mehmet (1983), for example, concludes that the outcome of etatism was a noncompetitive, closed economy dominated by state monopolies that were badly managed and increasingly overstaffed.

Attempts to revive economic liberalism and promote free enterprise in the 1950s failed to attain the government's goals. In contrast to their own economic philosophy, the Menderes government kept on expanding the size of the public sector. The SEEs did not only expand their share within the economy but more importantly, they became objects of patronage politics. Loss-making SEEs multiplied as favouritism, featherbedding and political interference in their management became political tools.

The lack of planning was regarded the major cause of economic mismanagement under the Menderes administration and this gave way to the establishment of the SPO in the 1960s. In this period, import substitution industrialisation started to be implemented under successive five year plans as the principal development strategy up until 1980. But the role of the SPO in planning was frequently subject to political interference. Investment and allocation decisions were usually made by the politicians rather than the SPO technocrats. In the 1960s and 1970s, the planning technocrats and

politicians clashed many times. Politicians were usually on the winning side. They manipulated planning and relied on deficit financing to boost the growth rate. They were not only the driving force behind a highly protectionist import substitution industrialisation strategy, but politicians also led to the mismanagement of SEEs by protecting them from economic hardship and keeping their output prices low, and then covering their operating losses with state subsidies.

In short, the operating losses of the SEEs which were financed by transfers from the national budget, generated an unprecedented monetary expansion which in turn led to spiralling inflation in Turkey. However, despite these heavy losses of SEEs, the SEEs investments continued in an increasing manner until 1980, when a major structural adjustment programme in the face of severe economic crisis occurred.

CHAPTER 3: The Political Economy of Turkish Development in the 1980s: An Economic and Political Perspective

3.0 Introduction

This chapter analyses the dynamics of economic growth and changes experienced in the Turkish economy since the liberalisation and structural adjustment programme initiated in January 1980. It offers a discussion about the programme and its overall outcome as well as the reform attempts and the relative importance of public enterprise sector in the 1980s and early 1990s.

The 1980s was a decade of severe economic crisis and a return to democracy for an increasing number of peripheral countries of the world capitalist system. For Turkey, the decade was a particularly turbulent period. Turkey entered the 1980s facing dire economic circumstances. Inflation and unemployment were rising, shortages of basic commodities were common, labour relations were at crisis level often involving confrontational and prolonged strikes and lock-outs. But worst of all, political violence reached in its peak and spread throughout the country with about 200 politically motivated murders a month.

Within the above setting, the Turkish government announced a structural adjustment programme on 24 January 1980. The programme contained liberalisation and structural adjustment policies to remedy some of the most important structural problems of the Turkish economy such as inflation, public sector financing and foreign exchange receipts. In this chapter, much of the analysis elaborated concentrates on the macro development aspects of the Turkish experience occurred during the 1980s and early 1990s- so called post-liberalisation era. The figure behind

the reform programme, Özal, and his ideology are the subject of another section in this chapter. The chapter also focuses on the problems of the SEEs and attempts to reform them before assessing the general outcome of the economic policies pursued in the above mentioned period.

3.1 A macroeconomic outlook of the Turkish economy in the 1970s

In the 1950s and 1960s, Turkish state pursued a development strategy which aimed at fostering agricultural and industrial production, improving basic infrastructure, and integrating the rural and urban sectors into a single market economy. Implementation of this strategy resulted in a period of steady and substantial growth. The economic programmes were supported by IMF stand-by arrangements in the 1960s to provide a framework of domestic and external financial stability in support of the development strategy.

The process of Turkey's integration with the West started as a consequences of two factors; one the one hand, Stalin's plans of isolating Turkey from the West and incorporating it into the Soviet sphere of influence, and on the other hand, efforts made by the Turkish foreign policy makers to integrate the country into the newly emerging international institutions of the US-led Western world. In this manner, Turkey took two quite critical steps: first, it became a member of the OECD, and then Turkey joined the NATO in 1952. In general all these developments not only advanced the availability of economic resources, but also helped to strengthen Turkey's ties with the West, thus exposing the country to more liberal ideas and domestic policies.

In response to these developments, the Turkish economy showed a vigorous economic recovery together with high rates of growth in GNP in the 1960s and 1970s.

The average growth rate of GNP was around 6.5 per cent during the period of 1963-1977. Much of the growth in the economy was registered in expanding manufacturing and service sectors. The output growth of the agriculture sector, although relatively moderate, stayed consistently above that of the population with an average of 3.3 per cent per annum. These growth rates, compared to those of 55 countries that are within the same category, appear to be higher than their overall average rate of 6 per cent per annum (World Bank, 1980). This success, however, was realised by means of an import substitution strategy (ISI), which made the country critically dependent on imports of capital and intermediate inputs and on strong protection of the domestic market, to the neglect of the country's export potential.

In this early period, the Turkish economy had two very serious balance of payments crisis which ended in sharp devaluations of the currency rather than comprehensive reform packages. In August 1958, the first crisis came during the period of Democrat Party (DP) government. Since the response to the crisis did not contain any kind of a sound macroeconomic basis and the populist Menderes government continued deficit financing, naturally the situation soon transformed itself into a political and an economic crisis, and it ended up with the military coup of May 1960. Democracy in the country was restored within two years. The years following the coup brought about close co-operation with the IMF and the OECD.

However, since the underlying macroeconomic weaknesses and reasons continued to be ignored by 1970, the Turkish economy faced another foreign exchange crisis. Another major devaluation was considered as an efficient measure to overcome the crisis. It proved that it was not the case. In the meantime, economic and political instability further increased when the military issued a written ultimatum to the

political leadership of the country in 1971. The ultimatum forced the political parties to form a broad coalition government.

In modern Turkish history, there were three military interventions which occurred in 1960, 1971 and 1980. Thus, the role of the military in Turkish politics is an important question remains to be tackled. Indeed anyone reading about the Turkish politics during the past thirty years is going to quickly appreciate the role of the armed forces. There seemed to be a neat pattern of intervention every ten years with the soldiers reluctantly soiling their hands in order to clean up the mess made by corrupt and incompetent politicians. The first intervention in 1960 was justified on the ground of defending the constitution. The army overthrew the DP on the basis that Menderes and his party were running the country with total disregard for the constitution by relying on his overwhelming majority in parliament to justify his actions. In 1971, the military asked, Demirel (PM), to resign and did so again in September 1980. On the last two occasions, the governments were described as weak and inefficient, the source of anarchy and instability which threatened the very foundations of the state of which the armed forces were the guardians. The military regime in 1980 introduced the country a new constitution and a new political framework before permitting a tightly controlled general election in 1983. Hence, especially, the last military coup in 1980s led many foreign and Turkish observers to emphasise the role played by the army in Turkey's politics and history. However, today a role can still be attributed to the military especially in political sphere rather than in the management of the economy but this role has been gradually declining in an effort towards a more democratic and civil society in Turkey.[1]

[1] See Ahmad (1993) and Hale (1994) for a discussion on the role of the military in Turkey.

However, the Turkish economy entered the 1970s with relatively good macroeconomic indicators such as rapid economic growth combined with a moderate rate of inflation and a current account surplus. This was, firstly, much due to the major devaluation implemented in 1970. Secondly, it was the result of the Turkish workers' remittances from European countries, especially Germany, which rose sharply from an insignificant level of $273 million in 1970 to about $1.4 billion in 1974. This led to a sharp increase in foreign exchange receipts for the country (SIS, 1996).

After the mid-1970s, however, some of the macroeconomic evidence was indicating internal and external imbalances such as the rising trend of inflation, falling workers' remittances and stagnant export proceeds. Due to the recession in Europe in the mid-1970s, the contribution of Turkish workers abroad to the economy fell to $982 million in 1976 and remained at that level in next two years (SIS, 1996). Furthermore, the exchange reserves began to erode quickly with the rising import bills and debt-servicing payments. The current account moved from a surplus of $0.5 billion in 1973 to a deficit of $3.1 billion in 1977. The deterioration was particularly very serious in public finances. The PSBR, for instance, had reached the equivalent of more than 11 per cent of GNP in 1977 in comparison with 2 per cent of GNP in 1973. The failure of maintaining a realistic exchange rate further discouraged exports. Inflation continued to accelerate by rising from 43.8 per cent in 1978 to 67.8 per cent in 1979. Turkish government's debt mounted as the government attempted to finance imports (Kopits, 1987, p.8; SIS, 1996).

The Turkish authorities failed to take any serious measures to adjust the economy to changed conditions in the aftermath of the first oil crisis. Instead of increasing domestic prices of oil and other imported intermediate goods, the

government decided to finance the excess of expenditures over receipts by using foreign exchange reserves and borrowing from abroad. This policy turned out to be a costly mistake. As a result, economic growth was somehow sustained by large-scale short-term borrowing in 1975 and 1976, but substantial external payments arrears had begun to accumulate by 1977 which eventually led to a drying up of external credits (Çeçen *et al.*, 1994). Continuous deterioration of the economy and accelerating rate of inflation brought further problems. Wage settlements were growing ever larger, import shortages intensified, and double pricing of government-controlled commodities such as sugar, cigarettes, and cooking oil became almost standard. The black market exchange rate reached almost 40 per cent above the official exchange rate by the end of 1978.

For the government, there was nothing structurally wrong with the Turkish economy. It argued that the causes of the crisis were the inappropriate foreign payment policies and the quickening trend of inflation which started to rise in the second half of 1977 but the situation was quickly repairable. It was believed that some extra foreign financing and the rescheduling of short-term debts would help to improve the balance of payments, while a period of restraint in public sector finances would bring the rising inflation under control (Krueger and Turan, 1993). The coalition government headed by the RPP, refused to accept the economic package offered by the IMF. IMF wanted to devalue Turkish lira, lower wages, increase taxes, and to give priority to the export sector. The RPP and its leader, Ecevit, insisted that social unrest might erupt if the measures proposed by the IMF were implemented. The government offered instead to increase the size of export subsidies. Without the IMF support, international banks refused to extend further credit facilities to Turkey (Ramazanoglu, 1985).

Table 3.1: Macroeconomic Indicators of Turkish Economy, 1979-1995

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Real GNP growth (%)	-0.4	-1.1	4.1	4.5	3.3	5.9	5.1	8.1	7.5	3.6	2.1	9.2	0.3	5.9	8.1	-6.1	8.0
Inflation rate (annual WPI) (%)[1]	67.8	107.2	36.8	27.0	30.5	50.3	43.2	29.6	32.0	68.3	69.6	54.4	55.4	65.5	63.7	120.7	88.5
Current Account Deficit/GNP	-2.5	-5.8	-3.3	-1.8	-3.7	-2.9	-1.9	-2.5	-1.2	2.3	1.2	-1.7	0.2	-0.5	-3.6	1.9	n.a.
PSBR[2]/GNP (%)	9.4	10.5	4.9	4.3	6.0	6.5	4.6	4.7	7.8	6.4	5.6	10.5	12.1	10.6	12.6	8.0	5.4
SEEs' PSBR/GNP (%)	5.2	6.4	3.2	2.4	2.7	2.3	3.1	3.3	4.2	2.8	2.5	5.3	4.3	4.5	3.5	-1.9	0.8
Fixed Total Investments/GNP (%)	n.a.	21.9	21.9	17.7	19.8	19.3	20.8	24.4	25.4	24.0	21.7	22.0	23.0	26.6	25.1	21.0	21.5
Private Investment/GNP (%)	n.a.	10.7	9.1	8.1	9.8	9.6	9.4	11.1	12.1	13.0	12.5	12.0	13.0	19.0	18.0	16.0	16.4
Public Investment/GNP (%)	n.a.	11.2	12.8	9.5	10.1	9.7	11.4	13.4	13.3	11.0	9.2	10.0	10.0	7.6	7.2	4.9	5.1
Domestic Savings/GNP (%)	n.a.	24.3	27.9	25.5	24.2	24	26.6	24.7	25.5	26.1	25	23.5	21.3	n.a.	21.9	19.7	20.9
Unemployment rate[3]	13.6	14.8	15.2	15.6	16.1	16.1	16.3	15.8	15.2	14.4	n.a.	10.9	12.3	12.0	12.0	11.1	10.7
External Debt ($bn)	10.9	15.1	15.5	16.1	16.8	21.2	25.3	31.2	40.2	40.7	41.7	49.0	50.4	55.5	67.3	65.6	73.2
External Debt/GNP (%)	n.a.	23.5	24.7	32.5	35.7	41.0	47.5	54.7	59.0	57.8	52.0	44.5	44.6	35.1	37.6	50.3	43.0

Note: (1) average annual percentage change in inflation with wholesale prices; (2) borrowing requirement of the central and local governments, and non-financial SEEs; (3) percentage of domestic civilian labour force; n.a.= not available.

Source: The table was tabulated by the researcher from the following sources: Hershlag (1988), p.154-5; Kopits (1987, p.10), Krueger and Turan (1993, p.375), Çeçen *et al* (1994, p.40 & 47); TurkInvest (1993); OECD (1993b, p.201); OECD (1995b, p.A24 & A50); Petrol-Is (1995, p.666); SIS (1996); TÜSIAD (1993); TÜSIAD (1995); and TÜSIAD *The Turkish Economy*, various years; Treasury (1996); FTU (1996).

As a result of pressures put by the IMF and the OECD, the Turkish authorities made some half-hearted attempts to rectify the deteriorating economic situation at the end of 1977. Although some improvements took place in the current account, this was achieved by an excessive reduction of imports and only a small increase in exports. The measures taken by the government soon proved their inadequacy in relation to the severity of the economic crisis. Moreover, public sector finances continued to worsen, mostly as a result of a sharp increase in the operational losses of the SEEs.

One can summarise the situation so far as follows. The basic inward-looking focus of the Turkish development strategy between the 1950s and early 1970s had promoted a production structure biased largely toward supplying the domestic market, further discouraging exporters. This resulted toward the end of the 1970s in increasing rigidities and distortions, which intensified pressures on domestic resources. In addition, political instability, an unmanageable public sector deficit, unproductive SEEs, runaway inflation, heavily protected markets and domestic currency, and a serious balance of payments crisis due to improper and inadequate policies, together with the inherent difficulties of the political system, and, finally, the government's delay in responding appropriately to the first oil shock and ensuing adverse world economic developments, left very little room for manoeuvre in the face of the second oil shock in 1979-80.

By the end of 1979, Turkey was in the midst of a severe foreign exchange crisis. The country was unable to import essential items such as crude oil, medicine, sugar. Inflation had accelerated, and unemployment was widespread and increasing. Moreover, there was political turmoil, partly due to the economic difficulties and partly due to external influences. During the years leading up to the crisis (1974-79), annual GNP growth had declined to an average of 4.4 per cent. The public-sector

deficit expanded rapidly from less than 2 per cent of GNP in 1974 to more than 6 per cent in 1979, averaging 4.5 per cent in this period (Canevi, 1994, p.182).

Thus, Turkey faced the second part of oil price increases with an extremely weak economy, a grossly overvalued currency, virtually no foreign exchange reserves, strongly negative real interest rates, a very high rate of inflation, widespread unemployment, stagnant output, political turmoil, and an external debt in excess of $15 billion, more than a quarter of which was short-term.

The year 1979 was possibly the worst suffered by the Turkish economy in the post-war period. All the macroeconomic indicators registered a severe economic crisis in this year. The growth rate of real GNP continued to decline and became negative during 1979-80, -0.4 per cent and -1.1 per cent respectively. While unemployment soared to 14.8 per cent in 1980, inflation gathered momentum and reached an unprecedented triple-digit rate of 107 in 1980 (see Table 3.1).

3.2 The austerity programme: the 24 January 1980 Decisions

Facing the most severe economic crisis in the history of the Republic, the minority government led by Demirel's centre-right Justice Party finally realised the need and found the courage in itself to undertake fundamental reforms that would change the Turkish economy entirely. On 24 January 1980, the government introduced a major and comprehensive economic stabilisation package which proposed to change the orientation of economic policy. Behind the package was Turgut Özal, a powerful technocrat[2] in the position of undersecretary of the prime ministry.

[2] Williamson (1994) defines the term 'technocrat' as "an economist who uses his or her professional and technical skills in government with a view to creating and managing an economic system that will further the general good" (p.12). He further argues that the prominence of technocrats and the success of economic reforms go together. There are a number of a new breed of economic technocrats who assume positions of political responsibility in the 1980s and 1990s. Outstanding examples of those who are

The austerity programme which is popularly known in Turkey as '*the 24 January Decisions- 24 Ocak Kararlari*', apparently seemed to be qualitatively different from previous reform attempts because it attacked the sources of the economic crisis instead of seeking to deal with the symptoms. Thus it called for far-reaching structural changes in the Turkish economy in the coming years.

The policy reforms designed by Özal and introduced by the government in 1980 aimed to redress the economic situation and change the development strategy which had been followed by Turkey many decades. Özal introduced his economic package, and he summarised the country's economic picture as follows:

> An unprecedented level of inflation above 100 percent; shrinking foreign currency earnings; a growing black market; falling production; a rapidly rising rate of unemployment; shortages; falling rates of investment; an increasingly unequal distribution of income. It is, in short, a dark picture (cited in Çölasan, 1984, p.313).

In order to overcome these problems, in Özal's view, the following measures had to be taken:[3] (1) Co-ordination and coherence must be introduced in national economic decision making; (2) in the economic management of the country, great weight must be given to general macro level measures while detailed intervention must be avoided in order to allow the economy to develop through the natural laws of the market; (3) SEEs must be made productive and they must no longer be subsidised by the state; (4) private enterprise must be encouraged to the maximum; (5) A realistic foreign exchange rate policy must be pursued in order to balance foreign trade and raise foreign currency earnings. The overvalued exchange rate has rewarded importers and punished exporters, thus special measures must be taken to promote exporters; (6) given the rate of investment is unlikely to be increased in the short and medium term,

currently holding office or held earlier are Mexican President Carlos Salinas, Economic Minister Domingo Cavallo in Argentina, Prime Minister Yegor Gaidar in Russia, Prime Minister and late president of Turkey, Turgut Özal.

[3] This part was summarised from the book of Çölasan (1984) and TÜSIAD (1992, p.43).

this must be compensated by an inflow of foreign capital; (7) domestic demand needs to be reduced in order to increase exports. This must be achieved not only through monetary measures but also through linking wages to the rate of inflation; and (8) tax revenues must be increased by a reform of the tax system (Çölasan, 1984, p.314-15).

This major stabilisation and economic liberalisation programme had short-term and long-term objectives as can be seen from Özal's diagnosis and recommendation. The short-term objectives of the 24 January Decisions were to reduce the rate of inflation, improve the balance of payments situation through rapid export growth, and therefore re-establish Turkey's creditworthiness. Restoring equilibrium and economic growth were the objectives of the programme in the long run (Çeçen *et al.*, 1994; Baysan and Blitzer, 1990).

Specific policy objectives were also included in the programme. It was said that a greater role for the private sector would be given by encouraging privatisation and the range of sectors dominated by the public sector would be limited. A SEEs reform package[4] would be prepared in order to reduce the burden of SEEs on the budget and to improve their efficiency (Baysan and Blitzer, 1990, p.11).

The government, simultaneously, entered into negotiations with the IMF officials and other creditors. Negotiations with the IMF resulted eventually in a three-year stand-by arrangement in the amount of Special Drawing Right (SDR) $1.25 billion in mid-June. Later in the same month, Japan agreed to reschedule Turkey's $85 million debt, while the EEC released $336 million in aid over five years. Meanwhile, a total loan of $1.1 billion was obtained from the OECD in April. The

[4] In 1982, a report about SEEs reform program was prepared by Mustafa Aysan, the Minister of Transport and Communications in the transitional government. In his report, Mr. Aysan proposed a model involving the organisation of SEEs as sector holding companies which would have made the SEEs to work according to the requirements of the day and facilitate the privatisation process. However, the report was never put into practice. For details see Karatas (1986) and Akinci (1990).

OECD also agreed to reschedule Turkey's $2.9 billion debt which had already been rescheduled in 1978 and 1979. These negotiations continued with other institutions later on. After gaining the IMF's and the World Bank's stamp of approval, in particular, for its new economic regime, Turkey was able to obtain a net foreign aid inflow of over $1.5 billion in 1980. This, consequently, helped the country to unlock its foreign trade bottlenecks. This foreign currency inflow gave the Turkish economy some breathing space (Canevi, 1994, p.182; Kopits, 1987, p.9; Çeçen *et al.*, 1994, p.44).

The government quickly started to implement the measures required in the reform package in order to overcome the problems the country was facing. *Firstly*, the Turkish Lira (TL) was immediately devalued from TL45 to TL70 per US dollar, and it was announced that, henceforth, exchange rate policy would be more flexible, and more frequent devaluations would occur in the future in order to maintain the attractiveness of exports. In the meantime, several other measures were taken to support exports and to reduce the restrictiveness of import regime (Krueger and Turan, 1993, p.357). The Banking system was greatly liberalised especially regarding foreign exchange. Moreover, a number of incentives for exporters were introduced and enhanced. All duties on imports used in export production were eliminated, and more importantly administrative procedures relating to exports were to be greatly simplified. The basic step towards the liberalisation of imports was also taken in the early 1980s. The import regime classified the goods to be imported under three separate categories as goods whose import is prohibited, those subject to permission, and those that are liberated and can be imported by paying a surcharge.

Fairly conventional policies were undertaken for the restoration of macroeconomic balance. These included the raising of interest rates and the

imposition of controls over public expenditures. The government also initiated a number of radical measures to improve its budget deficits such as the removal of controls over SEE prices which is going to be discussed in detail later in this chapter.

3.3 The ideology behind the reform programme: Turgut ÖZAL

Today, without any doubt, it is possible to argue that Özal was the architect of the Turkish economic liberalisation undertaken in the 1980s. Furthermore, no Turkish leader since the founder of the republic, Atatürk, has presided over such profound changes in his country as Özal, and none of the Turkish politicians, since Menderes (who was the prime minister throughout the 1950s), has set his personal stamp so firmly on the country's politics (Ash, 1991). Thus, it becomes imperative to examine the ideology of Özal in order to understand the decade of the 1980s which was the beginning of a new era with eight years of uninterrupted Motherland Party (hereafter, MP) rule and eleven years of complete domination in economic management and politics of the country by one man; Turgut ÖZAL.[5]

Özal worked at the SPO as an undersecretary between 1967-1971 and then he left his post to work at the World Bank in Washington and he worked there between 1971-79. Then he came to Turkey and started to work in the private sector, and finally he became the chairman of the MESS (the Metal Employers Union), one of the country's leading employers organisation before being appointed as an undersecretary to the prime ministry and the head of the SPO. During this time he accepted the responsibility of preparing a reform programme (*the 24 January Decisions*) which would change the Turkish economy entirely (Margulies and Yildizoglu, 1988; Ulagay, 1989). Özal's job ended with the military coup in 1980 as a chief economic advisor to the Demirel government. However, his role continued in implementation of the

[5] Özal died in April 1993 from a heart attack.

reform package during the military period at an increasing level. At the end, the banker's crisis in June 1982 forced him to resign, and then he decided to enter politics and won the general elections in 1983 with his newly established party of Motherland.

The economic philosophy of Özal was shaped not only by his personal inclination and beliefs, but also and particularly by the challenge of the distortions and de-stabilisation of the economy. This was due to over-centralisation, and inefficient bureaucracy, the trial-and-error policies of frequently changing governments with biased vested interests and the natural limitations of relatively short-term actions taken by short term and weak coalition governments. In his government programme in 1983, Özal declared that:

> During the terms of various coalition governments, decisive and effective measures could not be taken when a potential crisis was predicted and whatever piecemeal measures were taken only made the problem worse (cited in Hershlag, 1988, p.42).

Even though his economic programme contains various ingredients such as better treatment of private enterprise, greater encouragement of exports and improvement of external accounts and relations, the main pillars of his economic philosophy were basically free enterprise and the market mechanism which were occasionally substituted by an alternative terminology of a "liberal economy". This old Smithian-Ricardian notion was banded together with more modern monetary theories and, against the background of the Turkish economic crisis of the late 1970s and early 1980s, this led to more comprehensive and concerted economic policies at least in principle. As we also elaborated earlier, these policies demonstrated a clear departure from import substitution to outward-oriented strategies. He presented a comprehensive economic concept and programme, especially after he took full power and leadership following the 1983 elections (Karluk, 1994).

Özal believed in the incentive system of free enterprise and the individualism of the 'economic man'. He saw a direct causal link between economic liberalism and political freedom. He explained that as follows:

> Economic liberalism and political democracy are heterozygote twins. Our special emphasis on liberal economic policies is a radical departure from the previous experience. We believe that homo economicus is the basis of individualism. An economic actor free from the strings of state is better placed to defend his individual political rights as well (Özal, 1987, p.161).

He continues by saying that when the individual is the decision-maker this makes him 'more responsible, more motivated, and individually stronger'. Özal strongly believed that "the state has the prime duty to remove constraints on economic freedoms and create conditions of free competition" (Özal, 1987, p.162).

These are the ideas which put him in line with the general thrust of the New Right politics which has prevailed in many other countries of the capitalist world. Even some compare him with Thatcher or Reagan because of his commitment to free market principles (Mackenzie, 1993; Aktan, 1988, p.47). An article written by Önis notes that some of the policies pursued by the Özal government "clearly aimed at instituting Thatcher style popular capitalism in Turkey" (Önis, 1991b, p.248).

Indeed, as Özal convincingly argued for the relegation of idea of 'development' as an objective of the state policy, the objective of the New Right was to put an end to the practice of an 'enterprise state' too. That is to say that the state would no longer pursue goals such as 'development', 'social welfare', and so on.

In the Turkish context, particularly, Özal argued that the main objective for Turkey must be following the footpath of western capitalist economies and joining the global economy. In order to do that, Turkey must liberalise her economy, implement all the necessary elements of free market economy, reduce the over-weight role of the

bureaucracy within the economy and in economic management, and take all the measures to make democracy work like a Western one (Ulagay, 1989).

The question here is if all these ideas were Özal's original ideas. Perhaps not. As a matter of fact, if one examines the recommendations made by the World Bank and the IMF, one will find that there are great similarities between these institutions' recommendations and Özal's ideology. Themes such as reducing the scope of public sector within the economy, budget restraints, free market, liberal economy, were the fashionable terms of political economy in the 1980s.

Özal principally aimed to reduce the role of the government in the economy, reduce the share of the public sector in manufacturing, and according to him, the private sector should be encouraged to enhance the development of the country. But Özal knew very well that the Turkish private sector was not able to perform this task all by itself. So, in which areas of the economy should the state invest or should have the duty of investment? Again Özal recommended that the state in the Turkish context should concentrate its policy largely in the fields of infrastructure, health and education. But on the other hand it was quite clear that the existing infrastructure was unable to serve the new economic programme. Thus, the state gave top priority to investments in the fields of energy, transportation, telecommunications, and urban and rural infrastructure (Ulagay, 1990, p.49).

Özal's ideas may not be very original but it is evident that as Ash (1991) puts it "Özal set the pace for a wide range of economic and financial reforms that have transformed Turkey". That was something which many other leaders of his time could not achieve. Further, perhaps the most important of all, Özal, more than any other Turkish politician, had a vision for his country. He firmly believed that by the end of the century Turkey would be economically 'the Japan of the Middle East'. He worked

hard for these grandiose dreams. Özal was committed to free markets and the private sector as the preferred vehicles for stimulating economic growth and development. For example he practically set aside five-year economic planning which previously used to be drawn up and implemented by the SPO in the country. Özal and his ambitious drive for free market economics was quickly surrounded by a small group of technocrats of like mind. This group, popularly known as '*the Princes*' in Turkey, were dependent on, and loyal to, Özal and became key figures in the implementation of the economic programme during the latter half of the 1980s (Önis and Webb, 1993, p.36).

It is essential to point out that Özal had also many failures in particular in the years after 1987. For example, Özal did not cut the bureaucracy as he had said he would. Nor did he come through on his promise to force the SEEs, which still today control most of the raw material supplies to industry, to reverse overmanning and aim for real profitability. In this respect, the privatisation programme has never really taken off. After a decade of privatisation efforts, there has been little success, and the Turkish SEEs continue to be one of the major sources of economic imbalance and patronage as will be discussed in the next chapter.

Özal was also quite successful in generating a sense of optimism that things were going well, and that they were going to get better. He and his party represented new ideas and approaches which were changing Turkey. They were leading the country into a new era. And today the achievements of market orientation in Turkey are tribute to Özal's years in charge of the economy. Most people agree that Özal did a great job in the 1980s. Denials notwithstanding, the victory of Özal and the MP at the polls can be regarded as evidence of the mandate given by Turkish public to continue the applications of reform policies over a long period starting from 1983 up

until 1990. It is believed that his personal popularity had an great impact on the election victories of the MP.

However, going back to the reform programme, Özal and his team were facing many problems with the implementation of the programme. The most important problem was the political weakness of the minority government which prevented it from supporting the programme firmly. Despite months of long sessions, the president of the country could not be elected in the Parliament. Thus, some of the very important legislation to carry out the stabilisation programme, could not be passed from the Parliament because they needed to be signed by the president in order to be published in the Official Gazette.

The coalition government was also under great pressure from all relevant interest groups such as labour organisations, agrarian groups etc. There was even a clear division within the ruling Justice Party over the desirability of some of the measures, particularly, those concerning the 'agricultural' constituency. Within that setting, political and economic turmoil continued. The first nine months of 1980 witnessed the largest strike wave in the Turkish history while the civil unrest in the country continued with increasing political violence and, law and order broke down completely just before the military stepped in.

3.4 Implementation problems of the reform programme: The military coup

On 12 September 1980, a military committee, under the command of the Chief of Staff of the Turkish Armed Forces, General Kenan Evren, intervened in the politics. The military suspended parliament and banned all political parties and workers' organisation. The National Security Council comprising five generals, declared that it

would follow the ex-government's economic policies. So the stabilisation phase of the structural adjustment programme started under the military rule (Hale, 1994).

The military leadership of 1980-83 had identified their mission as saving the political system from total collapse, restoring law and order, making the administrative machinery work and bringing discipline to public life (Çölasan, 1989, p.31). The coup itself was not a surprise to the people and brought immediate relief from daily violence and terror. Thus, the military easily gained the 'consent' and the 'high degree of support' from the public to implement their policies. The 'law and order' rhetoric was particularly effective among the working-class neighbourhoods which had especially suffered from the civil unrest in the 1970s. The generals, however, were not well qualified people in questions related to the economy. They knew that at that time a major stabilisation programme was being implemented. The military rulers wanted the reform programme, which appeared to have been working well so far, to succeed. They preferred to concentrate on matters like law and order rather than diverting their attention to the problems of the economy.

Therefore, the military leadership did what seemed to be logical under the circumstances. After taking over the government on September 12, they asked Özal to continue with the reform programme. Further, General Evren, made it very clear that the military would support the stabilisation programme and they would try to take all the necessary measures including the enactment of new legislation to make the programme work effectively. Evren also added that he was confident that the nation would be brave, sacrificing, and patient in those hard days. Özal accepted the job offered to him and he became deputy prime minister practically responsible for all economic affairs. In order to carry out the newly adopted policies, Özal asked the military to keep his team, whose members were specially recruited by him, and this

was accepted too. The characteristics of those who were involved in the team are worthwhile mentioning here.

The team consisted mostly of engineers who had worked at the SPO in the late 1960s and early 1970s. Many of them had then left government service to get jobs in the private sector. They usually came from lower middle-class backgrounds. They were not the children of the bureaucratic elite who had dominated the republic under the single-party system. They were not committed to the etatist ideology, but instead they tended to prefer the development of private enterprise. Having worked in the government and in the private sector, they knew both. They were in a position to bring in a private enterprise orientation to those parts of government responsible for the economy. They would also be in a better position to relate to the private sector and establish better communications with them. Furthermore, they had all worked earlier with Özal. They knew each other, they had confidence in each other, and they would take orders from Özal (Krueger and Turan, 1993; Yalman, 1993). By and large, this was the team, under the leadership of Özal, which had the command of economic policy matters in Turkey in the 1980s.

However, by accepting his new post, Özal also received a mandate to proceed directly with whatever fiscal adjustment he thought necessary. He intentionally presented himself in the press as acting minister only on economic considerations and stated that he had nothing to do with political matters (Ulagay, 1987; Önis and Webb, 1993, p.52). While the military leaders asked the nation to be brave, sacrificing and patient, Özal, as economy minister of the military regime, was particularly effective with his rhetoric of '*There is No Alternative*'. He tried to convince the people that economic crisis could only be overcome, '*if and only if*' the new policies were continued steadfastly over a sufficiently long period of time (Yalman, 1993, p.14).

Özal served in the transitional government as a deputy prime minister from September 1980 until a bank and brokerage house crisis in July 1982 led him to resign.

An examination of this period has to ask the question if there is a direct link between the economic stabilisation programme and the adoption of authoritarian rule. As an interesting coincidence there were three stabilisation programmes after the post-war in the history of the republic and each of them had been followed by military interventions by the Turkish Armed Forces. For example, the stabilisation measures of 1958, 1970-71 and 1980 all ended up with military takeovers in 1960, in 1971 and in 1980 respectively. Though all three interventions were justified on political grounds, the problems were economic in nature causing both the political instability and then the military interventions. However, it is difficult to establish the causal linkage and to produce a clear evidence to prove the direct link between the economic stabilisation programme and the adoption of authoritarian rule. But, on the other hand, it was implicitly accepted that military rule played a significant role in the implementation of hegemonic strategy and establishing an authoritarian regime (Yalman, 1993, p.14). Özal, for instance, openly acknowledged the role of the military. In his opinion, the military administration contributed to the success of the stabilisation programme. He stated in a speech to a group of a businessmen that:

> If the Intervention of September 12 [in 1980] had not been conducted, we would not have been able to obtain the results of the economic programme. Anarchy was on the rise and the tax laws did not go through the National Assembly. We should be thankful that a tax reform has been conducted ... (cited in Ulagay, 1987, p.63).

After the military coup, the implementation of the reform programme continued. The military administration turned its attention into three particular areas; reorganising the labour-industrial relations system and enacting new tax legislation, and freeing interest rates. Indeed, these three elements were linked to the goals of the stabilisation programme.

Industrial wages of union workers had risen rapidly while labour productivity had been falling during the period prior to September 1980. But the rise in real wages was the result of labour union militancy which had intensified as other centres of power in Turkish society were getting progressively weaker. The tense relationship between workers subscribing to different ideologies and belonging to rival unions, often caused slowdowns, work stoppages and the strikes and lock-outs with an increasingly disturbing union militancy. As Table 3.2 below indicates, Turkish industrial relations was very tense towards the end of 1970s. In 1979, there were 126 strikes involving 21 thousand strikers and this resulted over 1.1 million lost days. This increased to 220 strikes with almost 85 thousand strikers and 7.7 million lost days respectively in 1980.

Table 3.2: Industrial Relations, 1979-1992

Years	Strikes	Strikers	Days Lost
1979	126	21,011	1,147,721
1980	220	84,832	7,708,750
1984	4	561	5,000
1986	21	7,926	235,000
1988	156	30,057	1,892,000
1989	171	39,435	2,911,000
1990	458	166,306	3,466,000
1991	398	164,968	3,809,354
1992	98	62,198	1,153,578

Note: Between 1981 and 1983, strikes and lock-outs were banned by the military regime with new legislation. No data was available for the period of 1993-96.
Source: Margulies and Yildizoglu (1988, p.145); Sönmez (1992, p.150); TÜSIAD (1994, p.40).

Since the aims of the stabilisation programme favoured a reduction of the real wages of workers, the military introduced a number of measures besides restoring the law and order. Specifically designed measures aimed to curb the political power and the bargaining stance of labour unions. The first measure was to ban strikes and lock-outs. Secondly, wage negotiation under collective bargaining was also suspended. A

high council of arbitration (*Yüksek Hakem Kurulu*) which consisted of representatives of employers, labour and government, was established to determine wages until such time as normal political process were restored. The military administration also decided to close down the second largest but politically the strongest confederation of labour in the country. The Confederation of Revolutionary Labour Unions, known as *DISK*, was a Marxist-Leninist labour union which had been growing rapidly due to mainly its ability to negotiate high wage contracts. This confederation also showed its political potential by organising massive demonstrations in big cities which occasionally had a paralysing impact on urban life.

Table 3.3: Functional distribution of income and real wages, 1978-1990

Years	% of GDP			at constant prices (1978=100)		
	Profits and Rental Income	Wages	Agriculture	Civil servants	Private sector workers	Public sector workers
1978	38.1	35.1	26.6	100	100	100
1979	42.8	32.7	24.3	87	85	93
1980	49.4	26.6	23.8	57	71	83
1981	52.1	24.6	23.1	59	79	88
1982	53.6	24.5	21.7	62	79	83
1983	54.6	24.7	20.5	57	71	79
1984	57.9	21.5	20.4	51	69	67
1985	62.0	18.8	19.0	51	67	58
1986	64.2	17.7	18.0	53	64	53
1987	65.4	17.0	17.6	49	58	51
1988	70.2	14.0	15.8	45	52	43
1989	--	--	--	55	65	60
1990	--	--	--	63	80	75

Source: Dereli and Zeytinoglu (1993), p.697; Çeçen *et al* (1994), p.51.

The military regime created a new legal framework for the Turkish industrial relations system besides keeping wages down, and some of these provisions permanently weakened Turkish labour in its relations with employers. As can be seen in Table 3.3, the real wages of the public sector workers dropped by 25 per cent between 1978 and 1990. For civil servants, who did not have the right to organise or

bargain collectively until recently, the decline was even sharper. The real wages of bureaucrats in 1990 amounted to only 63 per cent of their 1978 level. Workers in the private sector appeared to be slightly better off than those in the public sector in the same period. A declining trend of wages and salaries continued throughout the 1980s, and as Table 3.3 shows, the real wages of the Turkish working class in 1990 were 20-37 per cent below the level of 1978.

The impact of the reform programme on the functional distribution of income was quite significant too. The policies pursued in the 1980s were not only unsuccessful in bringing about any improvement in terms of income distribution but they even made it worse by reducing both the share of wage and salary earners, and the share of the agricultural sector in national income by almost 50 per cent in just eight years. Table 3.3 shows that capital income receivers increased their share from 38.1 per cent of domestic income in 1978 to 54.6 per cent in 1983 and then to 70.2 in 1988, whilst the share of the wage and salary earners, and agricultural producers dropped by approximately 50 per cent in the same period. The high inflation rates also caused some serious problems on wage earners in this period than any other group within the society due to the fact that wages were not index linked. Thus, workers were faced with constant erosion of real wages, and this consequently tended to worsen the already serious problem of income inequalities.

The second area of policy where the military administration concentrated was taxes. The major concern of the reform programme was not so much to establish a tax system which was more equitable but to increase government revenues and close the fiscal deficit. The civilian governments failed to enact the new tax laws but the military government increased the tax liabilities of the nonsalaried while it revised the income tax schedule in order to reduce the burden of wage earners.

Finally, setting interest rates free were the third policy area in which the military administration was compelled to take action. This time the military leaders were to some extent forced to react to a situation which had emerged as a consequence of measures adopted to implement the stabilisation programme. With the establishment of free interest rates, a network of stock and bond brokers (confusingly known as *bankers* in Turkish) began to emerge and started to extend credit beside the conventional banks in Turkey. Since they were not subject to the regulations of banks, these brokerage institutions collected large sums of money, mostly from small-scale savers, with offers of higher interest rates than banks on tradeable deposit certificates, and with promises to convert them on demand immediately. Such deposits were transferred to illiquid firms by the brokers. During these days, it was not unusual to find depositors including junior and middle-ranking army officers who actually sold their homes and trusted their entire savings to these brokers in the hope of making quick profits.

In 1982, when the entire system collapsed, creating chaos in the finance sector, the amount of money bankers controlled is estimated at around one-fourth of the money in circulation in the summer of 1982. Since neither the banks nor the brokers were making as much money from their loans as they were paying in interest on deposits, heading for a crash in the financial market was almost unavoidable. The crisis appeared when many brokers including the famous Banker Kastelli[6] became insolvent, several enterprises and banks faced liquidity shortages. Depositors rushed to brokers to claim cash for papers they held but there was neither any cash available nor anyone responsible (Krueger and Turan, 1993; Hale, 1994).

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[6] *Banker Kastelli* was owned by Cevahir Özden and it was a nationally known broker house mainly due to its persuasive TV advertising which encouraged thousands of people to invest their entire savings in its high-yield bonds.

The military government and the Central Bank immediately responded by extending official guarantees for the deposits of small savers and offered help to firms and banks in an attempt to prevent political unrest (Yesilada and Fisunoglu, 1992). It was reported in Turkish press that there were many army officers among those who lost their money in the banker crisis. It was thus argued that the military government would have been very reluctant to respond to the crisis and lessen the loss of small investors if there had not been any pressure by the army officers. Özal and the minister of finance, Mr. Kaya Erdem who was a close friend of Özal, felt that the government should not do anything about the crisis. Their opinion was that people had deposited their money with institutions which paid higher interest, but that brought with it higher risks. For Özal and Erdem, it seemed desirable for people to learn how a market system operated, and that high returns were usually accompanied by high risks.

However, for the first time since they started to work together, the military leadership was significantly of a different opinion than economic management of the country. Therefore, those who had assumed the responsibility for the implementation of the programme were asked to change their policies, and further, Mr. Erdem was asked to resign. But financial deregulation and interest rate liberalisation were the main pillars of Özal's reform programme. So, Özal took the matter personally, and on 13 July 1982, both Özal himself and Erdem resigned from office rather than accepting major policy changes which they felt would undermine the entire programme.

Right after Özal left the office, there was a shift of policy. Government control over banks was increased. Some of the bankrupt companies were bailed out by being taken over by the government banks or being turned over to state enterprise who would bring them back to financial health. The person behind these changes was Mr.

Adnan Baser Kafaoglu, another high-ranking bureaucrat of the Ministry of Finance who served as an economic advisor to President Evren. He was much more representative of the traditional bureaucracy of the ministry, and he was radically different in many ways than Özal. When he became the finance minister, the members of the Özal team started to leave their posts since they would not work with the new minister and the reform programme apparently lost momentum. The new team under Minister Kafaoglu relaxed the monetary and fiscal restraints on economic activity and inflation began accelerating (Önis and Webb, 1993, p.5).

3.5 The liberalisation phase (1984-1991)

Shortly after the resignation of Özal, the military government announced that elections would be held in the autumn of 1983. Özal immediately set up a new political party, the Motherland Party, and he won the general elections with a comfortable majority, which marked the beginning of a new era of free-market economy in the history the Turkish republic.

The new Özal government started quickly to regain the momentum of policy reforms. Changes proceeded rapidly over the next three years. The reform package and objectives after 1983 focused almost entirely on achieving structural changes within the economy, especially with regard to the role of import-competing and export industries on the one hand, and the role of the private and public sectors, on the other. The goal of stabilisation was largely forgotten as government expenditures begun rising sharply, and inflation once again accelerated (see Table 3.1). Unlike earlier fiscal expansions, however, this one was geared largely toward increased expenditures on infrastructure, while SEEs remained subject to fairly strict controls.

The second phase (i.e. 1984-91) of the government's liberalisation programme began with a number of major policy changes. These included major reforms in the financial sector (e.g. banking deregulation, freeing of interest rates, opening the Istanbul Stock Exchange, creating a foreign exchange market, and reduction of taxes on financial transactions), tax reform (e.g. the introduction of value added tax in 1985 and a reduction in the highest marginal rate of income taxation from 45% to 25%), and increased incentives for efficiency in the SEEs. This period also witnessed the beginning of the privatisation programme.

In mid-1983, despite the much greater stability of the real exchange rate and the significant increase in exports, there were still many restrictive aspects of the Turkish trade regime. Therefore, it was announced that there would be moves toward a unified exchange rate and elimination of special rates and that the trade regime would be further liberalised. A major change was made in the Import Lists and import procedures were also greatly simplified. The government also reduced restrictions surrounding convertibility of the Turkish lira and announced that steps would be taken to make the lira convertible. Foreign banks were encouraged to open branches in Turkey. After July 1988, foreign investors were permitted to enter the Turkish capital market, and June 1989, foreign investment funds were allowed to operate in Turkey.

Furthermore, steps were taken by the Özal government to increase the attractiveness of Turkey for private foreign investors. The new policy granted foreign capital the same rights and obligations as domestic capital, with guarantees of transferring back profits, fees, and loyalties, as well as the general relaxation of capital and exchange market controls. Some other measures were also taken in order to encourage foreign capital to invest in Turkey.

As a result of this policy, a sharp increase in foreign capital investment was recorded as illustrated in Table 3.4 below. In the period between 1959-1979, the total amount of foreign investment was only $228 million. After 1980, the rate of foreign capital invested in Turkey increased significantly and reached $1.9 billion in 1991, and in cumulative terms foreign direct capital inflows in 1980-91 period were over $8 billion. The same trend in foreign capital inflow continued in the first half of the 1990s. Between 1992 and 1994, the amount of foreign direct investment brought into Turkey was around $5.5 billion which makes a grand total of $13.9 billion foreign capital investment until the end of 1994.

Table 3.4: Net Foreign Investment, 1980-1994

Years	Number of Active Companies Involved	Amount of Foreign Capital Authorized (US$ million)
1959-79	----	228
1980	100	97
1981	127	338
1982	170	167
1983	185	103
1984	267	271
1985	421	234
1986	610	364
1987	839	536
1988	1,109	824
1989	1,542	1,470
1990	1,813	1,784
1991	2,040	1,909
1992-94	2,531	5,576
Total (Cum.)		**13,902**

Source: Margulies and Yildizoglu (1988, p.156); TurkInvest (1993, p.19); TÜSIAD (1995, p.124).

Liberalisation and simplification of foreign investment procedures in the late 1980s and the innovative formula of *build, operate and transfer* (BOT) attracted investment especially in the fields of tourism and energy. Tourism was the preferred sector for foreign investors among service industries. Consequently, investments in this sector helped boosting the potential tourism revenues in the mid-1980s. Turkey's

income from tourism increased four-fold from an insignificant amount of $327 million in 1980 to $1.4 billion in 1985. Turkey was able to increase this even further at the end of the decade by receiving $3.2 billion in 1990, and hosting more than five million visitors which was six times more than the 1980 figure (SIS, 1996). Not only the field of investment but also the number of companies involved significantly increased after 1980. Prior to 1980, about 80 per cent of foreign investment was in manufacturing sector involving 100 companies. While the share of manufacturing sector fell to about 50 per cent in the early 1990s, other sectors such as tourism, energy and telecommunications became more attractive for foreign investors which were represented with more than 2000 companies in 1991.

Even though the rate of foreign investment is accelerating since the early 1980s, it has been yet far from being satisfactory compared to the annual inflows in excess of $10 billion going to countries such as Spain and Mexico. It is difficult to identify a specific reason for the slow foreign capital inflow. As said, besides an expanding consumer market and its proximity to other export markets, Turkey has liberal foreign investment laws and offers generous tax incentives.

3.6 SEEs and their performance in the post-1980 period

The deficits of the SEEs have been among the major burdens of the budget since the 1930s. Various reform attempts were made in the past to reduce this burden, yet these were of little help. Within the framework of stabilisation programme, a fresh start was attempted in the domain of the SEEs in the early 1980s.

The aim was to promote the private sector and to reduce the role of the public sector through reform and privatisation. The emphasis was on decentralisation of decision-making, reduction to a minimum of state involvement and intervention in

management and financing, aimed at promoting self-sufficiency of current costs, growth of the participation of the SEEs' own savings and capital in investments, and compliance with the market mechanism instead of reliance on administrative government protection and subsidies. An important step was also taken by the Parliament in 1986, which approved the gradual privatisation of the SEEs.

Since the borrowing requirement of the SEEs accounted for two-thirds of the entire public sector deficits- around 6.4% of GNP in 1980 (see Table 3.1), the government had to take drastic measures to improve the performance of the SEEs. The removal of controls over SEE prices was one of the important aspects of the reform programme with its prospective impact upon the budget deficit. It was announced that, henceforth, prices of SEE outputs (except coal, fertilisers, and electricity) would be freely determined and government subsidies would no longer be given (with a few exceptions). The prices of most goods and services in particular those produced by the SEEs such as oil, steel, paper, cement and PTT services, were increased considerably averaging between 45 to 400 per cent with the announcement of the 24 January 1980 stabilisation package. Measures were also taken removing controls over many prices of goods and services provided by the private sector (Krueger and Turan, 1993, p.358).

Price increases reduced the SEEs' operating deficits significantly which in turn eased the government's deficit and inflationary spiral in the first half of the 1980s. The SEE accounts registered certain improvements starting with gross profits of TL7.7 billion in 1981, and TL66.7 billion in 1982, then a loss of TL34.4 billion in 1983, and again a gross profit of TL230.3 billion in 1984 - all in current prices. And a much improved gross profit in current terms of over TL1,200 billion in 1985. The overall financing requirements of the SEEs for extensive investment programmes increased

from TL735 billion in 1984 to TL969 billion in 1985, over and above the SEEs' own resources for that year (Treasury, 1996). Although in real terms the 1985 figure was even less than that for 1984, and meanwhile also the prices of SEE products rose significantly, SEE demand for public funds and domestic and foreign borrowing was still substantial.

Transfers from the consolidated budget to the SEEs, on the increase until 1983 in current terms, decreased in 1984 and still further in 1985. As a percentage of the budget, they fell from 12 per cent in 1981, to 2 per cent only 1985, but it remains unclear whether additional funds were not included in such budget items as 'other transfers' or 'investments'. In this context it may be noted that the SEEs' share in total public fixed investment amounts to over 90 per cent in mining and manufacturing, 60-70 per cent in energy and transportation, and over 20 per cent in tourism, while the main activity of a wide range of other services is left to government agencies other than the SEEs.

Budgetary transfers to the SEEs for the sake of continued and even growing investments accounted for 29 per cent of their total requirements for financing ventures in 1984, with foreign project credits plus other domestic funds supplying 49 per cent of these requirements. The balance came from the SEEs' own resources. A similar situation prevailed in 1985, with the SEEs providing 41.6 per cent from their own resources for net investments, the budget an estimated 20 per cent, foreign project credits 25.5 per cent, and price stabilisation and other funds, the balance, about 13 per cent.

However, prices were not completely relaxed until the mid-1980s, and political pressures continued to determine SEE pricing up to today. State monopolies in a wide variety of commodities such as sugar, tea, fertilizer, tobacco and energy were

abolished in order to increase competition. But many SEEs continued to enjoy monopoly status and none of the big SEEs was broken up to foster competition. The legal framework granting SEEs more managerial autonomy and independence from ministerial approval fell short of subjecting SEEs to the commercial codes applicable to private sector companies.

In terms of personnel, employment in most SEEs was slightly reduced, but expansion in other SEEs prevented total SEE employment from falling. Though there was a 4.3 per cent reduction in total number of SEEs personnel in 1981 and similar subsequent reductions were made during the 1980s, the total employment in SEE sector is still about 70,000 more in 1990 than what it was a decade ago. The share of personnel expenditures in total production costs also continued to rise until 1993 and it reached to 52.6 per cent compared to 23 per cent in 1982. This sharp increase in personnel expenditures is regarded as one of the main reasons for the ever increasing level of SEEs losses in the early 1990s (Karluk, 1994, p.119; High Control Board, 1995, p.69).

The privatisation strategy described in the following chapter failed to reverse the increasing burden of the SEE on government resources. The relaxation or removal of price restrictions helped the SEEs to improve their financial performance by the mid-1980s. As Table 3.1 shows, the share of SEEs in PSBR dropped to 2.3 per cent of GNP in 1984. Reduced public sector investment also helped to lower the SEEs' borrowing requirements. Between 1980 and 1990, investment in SEEs as a percentage of total public sector investment dropped from 67 per cent to 37 per cent. The drop in investments and increased competition came at a cost: profit margins shrank from 7.5 per cent in 1984 to 1.7 per cent in 1989, and sales per worker declined by 5 per cent. The return on capital in the SEEs dropped from 17.5 per cent in 1985 to 6.7 per cent in

1990- a rate about half of that for private sector firms; capacity utilization and labour productivity are about 20 per cent lower in the SEEs (ICI, various issues).

More importantly, the Turkish state did not become smaller nor it could not be 'rolled back' as intended in the 1980s (ASO Medya, 1994). In fact, there was a decline in the share of the public sector in manufacturing output. But, the share of the public investment in total investments continued to increase until 1988 due to the increasing level of public investment in infrastructure projects. One can easily observe that despite the rhetoric of the liberal approach during the period in concern, the public sector continued to be dominant in the economy. For example, in 1979, relative shares of the public and private sectors in total investments were 49.7 and 50.3 per cent respectively. In 1980, the balance shifted against the private sector with the public shares exceeding that of the private sector until 1988 (see Table 3.1; TÜSIAD, 1988; TÜSIAD, 1994). In 1987, relative shares of the public and private sectors were 52.4 and 47.6 per cent. This relatively high share of the public sector was mainly due to the goals of rapid economic growth pursued by the MP. The share of SEE investments in public sector investments declined considerably from 58.2 per cent in 1980 to 40.1 per cent in 1988, but the share of investments by local governments and the share of the investments carried out by the EBFs grew in the meantime. Moreover, the contribution of SEEs to GNP also increased during the 1980s, rising from 12 per cent in 1983 to 16 per cent in 1984, and reaching its peak point of 20 per cent in 1988. For the first time since 1980, nevertheless, the share of public sector investments in total fixed investments fell behind the private sector in 1988; they were 45.8 and 54.2 per cent respectively. This decline in public sector's share was thought to be due to significant cut backs in public infrastructure projects imposed by the fiscal crisis of the state after 1988.

At present, it is quite clear that the programme implemented in Turkey between 1983 and 1987 was expansionist in nature with heavy state investment in infrastructure acting as the main engine of growth. This policy strategy brought about budget deficits and an accelerating rate of inflation towards the end of the decade. In particular, the basic uncertainty of a high inflationary environment presented a major obstacle to the smooth functioning of the market. The MP government which had repeatedly declared its determination to fight the etatist tradition in Turkey to establish a real market economy was instrumental in bringing about a highly uncertain environment, hostile to its allegedly market augmenting orientation.

The evidence about the reform attempts of SEEs in the 1980s shows that the fundamental problems of the Turkish SEEs have not been resolved yet, and that SEEs are still not run as commercial enterprises. The government's social objectives (e.g. employment, regional development, agricultural support, inflation abatement, income redistribution, and industrial and infrastructure development) are the main reasons. Even when the social or non-commercial objectives meet the objectives set by the government, the cost of meeting these objectives appears to be usually high.

The SEEs have survived because of a "soft budget constraint" which made them immune from bankruptcy. The improvements in financial performance in the early 1980s quickly eroded and SEEs once again became a burden on government resources. As Table 3.1 shows, the share of SEEs in PSBR reached 5.3 per cent of GNP in 1990. The situation was even worse in financial terms during the early 1990s. The total loss of 18 SEEs was $3.5 billion which represented 2.6 per cent of GNP in 1994 (FTU, 1996; *Türkiye*, 25.7.1994; Central Bank, 1995).

This rapid deterioration in the public sector deficit in recent years has been the major cause leading to the emergence of macroeconomic imbalances. The average

public sector deficit to GNP ratio of 4.4 per cent between 1981-87 rose to an average of 7.7 per cent between 1988-92, before reaching the record level of 12.6 per cent in 1993 (TÜSIAD, 1995, p.33). The worst ever crisis in the history of the country occurred in 1994. This crisis, similar to the previous ones, emerged when the long overdue high volume of deficit in the public sector finances became unmanageable, leading to a catastrophic financial crisis in the first quarter of the year. The economy nose-dived. The inflation rate reached 150 per cent, the Turkish Lira plummeted against the dollar and industrial output shrank by 12 per cent. Another stabilisation programme in April 1994 was the policy prescription for the crisis. As a result, a reasonable success was achieved in the public finance deficit. PSBR to GNP ratio came down to 8 per cent in 1994 from 12.1 per cent previously (*The Banker*, 1994; TÜSIAD, 1995).

In summary, from their very beginning the Turkish SEEs have been a favoured target for widespread criticism, from inside and outside the country. While some tried to highlight the positive and pioneering task performed by the SEEs in preparing professional cadres (including for the private sector) and in promoting industrialisation in general, the supporters of free market ideology and pragmatic economists focused attention on their faults, mismanagements and deficits. These shortcomings cannot be denied; hence the recurrent attempts at reform. However, inefficiency and deficits of some SEEs (e.g. railways) are common in many developing countries. Furthermore, since many of the Turkish SEEs have a monopolistic or a quasi-monopolistic structure, it is rather doubtful how much efficiency can be achieved through mere price adjustments in a monopolistic market. Therefore, it looks necessary to change the micro structure of SEEs rapidly if high efficiency and the optimal allocation of resources is to be attained.

Despite more than a decade and half of reform efforts including their privatisation, the SEEs have continued to play a major role in the economy. The contribution of SEEs to the Turkish economy still accounts for 10-12 per cent of gross value added as a percentage of GNP, and they employ around 750,000 people which represents about 4 per cent of the total and 40 per cent of the industrial labour force. Their share in GDP and in industrial output, at the rates of 9 and 49 per cent, respectively, remained almost constant in the period 1978-83, though recently these shares have decreased to 7.8 per cent in GDP and about 40 per cent in industrial output.

3.7 A short assessment of the post-liberalisation era

In contrast to Latin American countries, the Turkish reform programme was regarded as more successful in the 1980s. Turkey, to some extent, presents the single most important case of '*life after debt*' in this period. Shortly after the austerity measures came into effect, the country's credit worthiness in the international market was restored and relatively high growth rates were resumed. However, it is now possible to study the somewhat 'mixed' results of this era and to assess the impact of the economic stabilisation and structural adjustment policies on Turkish economy since the early 1980s.

As indicated earlier, the programme was designed to solve the short and long term problems which the Turkish economy was facing. In the short term, the initial results of the programme were highly visible to all in Turkey. The programme led to a notable improvement in basic performance indicators. After the foreign currency problem was solved by massive foreign borrowing[7] and an impressive increase in

[7] Between 1980 and 1985, Turkey borrowed $1.7 billion from the IMF while the World Bank made available $1.6 billion in structural adjustment loans (SALs) (Çeçen *et al*, 1994, p.45; Kirkpatrick and Önis, 1991).

exports, shortages disappeared as import flows resumed and as power and petroleum shortages, and bottlenecks disappeared while the destocking of inventories also took place. Turkish export earnings reached to $5.7 billion in 1983 compared to $2.9 billion in 1980 (see Table 3.5). This obviously helped to improve rapidly the balance of the payments situation.

More specifically, in its stabilisation stage which was roughly the period between 1980-1983, the major success of the programme was to bring about a reduction in the rate of inflation. The shock therapy measures implemented worked efficiently and pulled the inflation rate down to an average of 30 per cent from a high level of 107.2 per cent in 1980. It remained at about that rate until the end of 1983. Although the rate of inflation accelerated in 1983 as government expenditures increased prior to the election and due to the policies of the new economic team which relaxed earlier restrictive monetary policies, the first two years of the programme must nevertheless be deemed to have been successful in achieving their objective of reducing the rate of inflation (see Table 3.1).

The growth rate of GNP was also restored despite worldwide stagflation. As the figures in Table 3.1 demonstrate, the real growth in GNP was 4.1 per cent in 1981, 4.5 per cent in 1982 and 3.3 per cent in 1983 compared to -0.4 per cent and -1.1 per cent in 1979 and 1980 respectively. The Turkish economy was successful in sustaining an average 4 per cent growth rate in the early 1980s. This growth rate was better than that of most developing countries in the midst of the worldwide recession and hence it should be regarded as a satisfactory outcome. It can be concluded that as a result of the stabilisation measures taken by the Turkish government, the short term targets of the programme were largely met and the Turkish economy once more succeeded in getting its wheels turning again. However, despite these short term achievements, the

long term outcomes of the programme are more doubtful. It is indeed very difficult to state whether any fundamental change has been achieved in the structure of the economy.

The GNP growth of the Turkish economy between 1984-1991 was much better than that one for the period of 1980-83 which was a steady and slow economic growth with the average of 4 per cent increase in GNP. As shown in Table 3.1, the growth rate of GNP did not accelerate until 1984 but thereafter growth rates of GNP were quite high by any standard in each year with an average of 4.7 per cent increase. This 4.7 per cent average increase was accomplished despite exceptionally poor economic performance and thus very low real GNP growth rates in 1989 and 1991 with 2.1 and 0.3 per cent respectively. Thus it seems fair enough to grade the growth performance of the Turkish economy as quite remarkable considering the failure of other debt-ridden developing countries in Latin America and elsewhere. The external financial assistance seems to play a crucial role in this success story. The study of Kirkpatrick and Önis (1991, p.34) reveals that between 1980 and 1984, Turkey received more than $1.5 billion in structural adjustment loans. This figure represented over one-third of all World Bank policy-based lending in the early 1980s.

The most spectacular results of the reform programme were in the area of foreign trade. During the 1980s, the Turkish economy achieved a tremendous export boom. With regard to exports, figures in Table 3.5 show that the total Turkish exports rose rapidly from $2.9 billion (5% of GNP) in 1980 to $7.9 billion (14.8% of GNP) in 1985, $12.9 billion (11.8% of GNP) in 1990 and then it reached $21.6 billion (12.6% of GNP) in 1995. The composition of exports has also changed radically in the 1980s. Table 3.5 also shows that the share of manufactured products (or the share of the industry) in total exports increased from 36 per cent in 1980 to 75.3 per cent in 1985 and 79 per cent in 1990 and then 87.5 per cent in 1995.

Table 3.5: Developments in Selected Foreign Trade Indicators, 1979-1995

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Total Exports ($bn)	2.3	2.9	4.7	5.7	5.7	7.1	7.9	7.4	10.1	11.6	11.6	12.9	13.6	14.7	15.3	18.1	21.6
Total Imports ($bn)	3.7	7.9	8.9	8.8	9.2	10.7	11.3	11.1	14.1	14.3	15.7	22.3	21.0	22.8	29.4	23.2	35.7
Total Exports/GNP (%)	2.6	5.0	7.9	10.6	11.1	14.2	14.8	12.7	14.9	16.5	14.4	11.8	12.6	9.3	8.6	13.6	12.6
Total Imports/GNP (%)	6.2	13.6	15.0	16.3	17.9	21.4	21.1	18.9	20.1	20.2	19.6	20.4	19.5	14.5	16.5	17.4	20.9
(%) of Manuf. in Total Exports[1]	n.a.	36.0	48.7	59.7	63.9	72.1	75.3	71.4	79.1	76.7	78.2	79.0	77.8	82.9	82.9	84.9	87.5
Foreign Trade Deficit ($bn)	-1.4	-5.0	-4.2	-3.1	-3.5	-3.6	-3.4	-3.6	-3.9	-2.6	-4.1	-9.3	-7.4	-8.1	-14.1	-5.1	-14.0

Note: The percentage of manufacturing in total exports includes all industrial products plus processed agricultural and petroleum products; n.a.= not available.
Source: TurkInvest (1993, p.16-17); TÜSIAD (1995); TÜSIAD (1996); Margulies and Yildizoglu (1988, p.155); Kopits (1987, p.10); SIS (1996); Treasury (1996); FTU (1996).

Export-oriented growth strategies also increased Turkey's exposure to international trade as a percentage of GNP. Total trade (i.e. import and export) as a percentage of GNP increased from 18.6 per cent in 1980 to 35.9 per cent in 1985 and then declined to 32.2 per cent in 1990 but it increased slightly again to 33.5 per cent in 1995. Seemingly a number of factors such as the fast depreciation of the Turkish lira, various export incentives in the forms of tax rebates and export credits, the Iran-Iraq war, and finally, the sudden drop in domestic demand, contributed to this export boom.

Some argue that the depreciation of Turkish lira, in particular, stimulated the export boom in the 1980s. The study of Krueger and Turan (1993, p.342) and Hershlag (1988, p.73) show that the lira was substantially depreciated against a seven-country basket of currencies and the US dollar in the early 1980s. In 1985, the real cost of foreign exchange in terms of domestic purchasing power was more than twice what it had been in 1979. The subsequent devaluations brought the value of the lira from TL526 to $1 in 1985 to TL2450 to $1 in 1990.

However, despite this sharp increase in export earnings and converting the Turkish economy into an irreversibly export oriented mode, it should be still emphasized that Turkey has not yet succeeded in penetrating into the world export markets in the way that Taiwan and South Korea did in the 1960s and 1970s. In contrast to the national reputation of present-day Korea and Taiwan as successful and high-quality product exporters, Turkish entrance to world markets, is frequently hampered by its lack of a previous track record in terms of reputation for quality, reliability of supply, and knowledge of markets. Indeed, efforts to penetrate the European and North American markets have so far proved to be largely difficult and unsuccessful.

Recent figures show that the share of Turkish exports in the total exports of non-oil developing countries to industrialised economies increased from 1.1 per cent in 1977 to only 1.6 per cent in 1988 (Çeçen *et al.*, 1994, p.50). On the other hand, the study of Yesilada and Fisunoglu (1992, p.204) indicates that Turkey's trade with the OECD countries, (most of them are members of the European Union) improved significantly by increasing from $4.1 billion in 1984 to $7.2 billion in 1989. An identical trend to exports is also observed for the imports. The share of imports in GNP rose from 13.6 per cent in 1980 to 21.1 per cent in 1985 and decreased slightly to 20.4 per cent in 1990 and the rate remained around 20-21 per cent until 1995. Therefore, the increasing trend in exports earning was mimicked by imports. Yet the improvements in export earnings could not reduce Turkey's trade deficit which stands at around $14 billion in 1995 (see Table 3.5).

Although results regarding the inflation rate at the beginning of the crisis were rather impressive and the inflation rate was reduced to 36.8 per cent in 1981 from 107.2 per cent in 1980, anti-inflation policies have been always on the agenda in the Turkish context since 1980. One may claim that one of the least satisfactory results of the stabilisation package is the persistent and rapid rate of inflation. It is important to emphasize that the matter of inflation had a high priority for Özal and his government. During the election campaign in 1983, Özal promised to bring inflation under 10 per cent within a year, but his government was not able to achieve this objective in the 1980s (Ulagay, 1987; Ulagay, 1989).

The data in Table 3.1 clearly indicate that the average inflation rate between 1981-95 remained around 55 per cent per annum and started to accelerate during 1988. It is very difficult to put forward a single reason but a number of factors may help to explain the existence of double digit inflation in the Turkish economy. Certain

policies were blamed for generating the high inflation rate in the 1980s. Some argue that continuous large government expenditures which were directed largely towards the development of infrastructure, were one set of reasons for existence of high inflation in Turkey (Hershlag, 1988, p.49; Mehmet, 1990, p.206; Krueger and Turan, 1993, p.376). Their studies find a positive correlation between the inflationary trend of the 1980s and the rate of increase in the consolidated government expenditure and the budgetary deficits. Others point out the wrong monetary policies employed by the Turkish government in the 1980s to curb the inflation. For example, Çeçen *et al* notes that:

> ... the failure of these policies stems from a neglect of the supply-side effects of these programs and to a certain extent from the insistence on a strict monetarist explanation of inflation that tautologically blames it on the growth in nominal money balances (1994, p.48).

According to Çeçen *et al* (1994), restrictive monetary policies and devaluations may increase the price level while decreasing the output, hence triggering a stagflationary process in a developing economy. Moreover, Çeçen *et al* argue that inflation cannot be curbed by reducing the growth rate of the money supply and the value of the Turkish lira *vis-à-vis* other foreign currencies.

The political economy of the Turkish economy which looks rather complex, can also be related to the analysis of the inflation problem. Undoubtedly, the real reason behind inflation primarily was, and still is, the overspending in the public sector both by the central government and the local authorities. Thus, it was suggested that the government should reduce public expenditure and increase taxation to tackle the constant problem of inflation (Margulies and Yildizoglu, 1988; Hershlag, 1988; Canevi, 1994). But governments had been reluctant to take this step, since it would certainly be unpopular in the short term. Instead, the successive Özal governments allowed a rapid increase in public expenditure noticeably before each election in order

to create a pre-election boom, or trade money for developmental projects for votes. Turks paid the price for this following each election year when the inflationary pressures mounted up. Following the 1983 general election, for instance, the rate of inflation reached 50.3 per cent in 1984 from 30.5 in 1983. A similar trend is again observed for 1988. Inflation touched a high point of an annual rate of 68.3 from 32 per cent in 1987 (see Table 3.1).

These trends in money supply also prompted warnings from the IMF and the World Bank in a number of reports. Reports specifically suggested that the government must reduce the budget deficit, increase exports, reform the banking sector, expand capital markets, freeze municipal and local administrations' spending, reduce the government support for the SEEs, and finally bring inflation under control. Despite all the warnings, the government never stopped spending irresponsibly.

As a matter of fact, this problem is not something new for those who study the political economy of Turkey. As Kopits (1987) explains, since the mid-1960s, there has been undisciplined monetary expansion, largely on account of deficit financing and loss-making SEEs. The Turkish Central Bank was too weak, and lacked the necessary independence to conduct an autonomous monetary policy during those years. Hence, in effect, money supply became a politically-determined variable. Even after 1980 this weakness has not changed, and at least in one respect it was reinforced by the creation of several extra-budgetary funds (EBFs).[8] The idea of setting up EBFs was to create agencies to fund priority economic activities, in spite of the temporary

[8] Until 1980, there were 33 funds which were all small and some were established in the 1940s. In the periods between 1980-1983 and 1984-90, 24 and 48 more EBFs respectively were added to the existing ones which brought the total number to 105 funds (Önis and Webb, 1993, p.39). At the end of the 1980s, the Public Participation Fund, the Mass Housing Fund, the Support Price Stabilisation Fund, and the Defense Industries Support Fund appeared to be the largest funds besides several smaller ones. In the 1980s, Özal closely controlled the funds as he did other aspects of Turkish economic policy but at the end of the decade the EBFs introduced as an institutional reform lost their original target of allocative efficiency in public funds and became one of the major sources of the financial disarray.

borrowing constraints on the central government, and it was also thought that imports of some consumer goods such as alcoholic beverages, cigarettes and luxury items, could be more acceptable, socially and politically, by putting taxes on those items.

From a political economy point of view, the revenue of the 105 funds increased considerably. The sum of these revenues was estimated to range around $3.5-6 billion in 1987-88, or from 1.3 per cent of GNP in 1980 to over 11 per cent in 1990 which was over half of all public sector revenue at the time (Bugra, 1994, p.145; Önis and Webb, 1993, p.40). Another serious organisational mistake of the EBFs regarding government spending is that the EBFs could make transfers to the general budget, or when a fund runs a deficit, it borrows as necessary. Although the loans to the EBFs carry a government guarantee, these loans are not co-ordinated in the government's debt management strategy. These types of borrowings accounted for an average of 25 per cent of total expenses for the funds in 1988-91, and in the same period, most alarmingly, the funds' borrowing shifted strongly to foreign sources.

The growing trend of foreign debt is another concern for the 1980s. Despite the export boom and the efforts to improve the country's current account, the external debt continued to grow from 23.5 per cent of GNP in 1980, 59 per cent of GNP in 1987 and 44.5 per cent of GNP in 1990 (see Table 3.1). In monetary value this translates to an increase from $15 billion in 1980, $40.2 billion in 1987 and $59 billion in 1990. This trend has continued in the 1990s and the total foreign debt reached to $73.2 billion in 1995. One striking feature of this increase in foreign debt is short-term borrowing, which started to increase again in the mid-1980s, and reached to $8.7 billion in 1987 from $2.5 billion in 1980 (Krueger and Turan, 1993, p.374). The trend is rather alarming because it suggests that long-term debt is retired by

transferring it to short-term debt. Moreover, almost all of Turkey's short-term debt is from private sources-commercial banks and private creditors.

Fixed capital investments in the private sector which is the best indicator of the health of the economy, have not grown substantially since 1980. Table 3.1 indicates the ratios of private and public sector investments to GNP in the country. During the period of 1980-1989, the ratio of total investment to GNP remained at the same level. The ratios of total investment to GNP was 21.9 per cent in 1980 and 21.7 per cent in 1989. The share of private sector investment in total GNP increased from 10.7 per cent in 1980 to 12.5 per cent in 1989. Public sector investment in total GNP declined from 11.2 per cent in 1980 to 9.2 per cent in 1989. Despite all the attempts by the government to leave matters of the economy to the private sector in conjunction with liberalisation efforts of the 1980s, the Turkish private sector showed a rather sluggish response for investment up until 1988. In early 1987, one internal World Bank report concluded that "high inflation is one reason why the response of the private sector [to the economic reform measures] remains below expectation" (cited in Leeds, 1988, p.171). The recent data shows that the private sector investment has been relatively higher than the public sector from 1988 onwards, until 1991. But again it needs to be recognised that the manufacturing sector, in particular, has failed to respond to new investment owing, in part, to the existence of unused capacity inherited from the pre-1980 era. However, it is hoped that if the plans for privatisation of SEEs progress in the future, the share of the private sector investment will gradually increase.

The leading private investment activity was in service sectors such as tourism, education, health, transport and communications which were stimulated by new privatisation opportunities in these sectors. A limited investment boom also occurred in the construction of housing, stimulated by the low-cost credits provided by the

Housing Development Fund to co-operatives, municipalities and private developers. The share of the manufacturing sector within private investment actually has declined from 28.8 per cent in 1980 to 12 per cent in 1985, whilst the share of transport and telecommunications increased to 29.8 per cent in 1985 from 18.1 per cent (Celasun, 1990, p.52).

3.8 Conclusion

This chapter has provided an overview of the stabilisation programme and its overall outcome in the 1980s and early 1990s. A World Bank report in 1988 stated that "Turkey's adjustment programme was undoubtedly successful and a major break from past policies that relied on import substitutions, market intervention and reliance on state enterprises" (cited in Kirkpatrick and Önis, 1991, p.34). In general, the overall outcome of the 24 January 1980 programme, known as the "decade of Özal, or Özalism",[9] can be characterized as mixed.

On the positive side, Turkey reoriented its economic-growth model from import substitution to an export-led strategy. As a result of more realistic exchange rates and the government's export-promotion policies, export earnings increased significantly and by the end of the decade the current balance finally emerged out of its constant deficit as shown in Table 3.1. However, the positive current account balance can also be attributed to a very strong growth in workers remittance in 1989-91 period, increasing tourism revenues, and in various short term capital investments. Within trade figures the share of industrial products increased from 36 per cent in 1980 to 79 per cent of total exports in 1990 and then to 87.5 per cent in 1995. Finally, the

[9] This period (1980-1993) has been termed as the "Özal decade" by Aricanli and Rodrik (1990), or "Özalism" by Aktan (1988) because of the influence of Özal on economic policy matters pursued in Turkey. See also Sönmez (1992, p.9).

liberalisation of the investment regime attracted a substantial amount of foreign investment into the Turkish economy in particular after the mid-1980s.

As to the negative results of the programme, some important observations can be made. Firstly, the export-oriented model failed to eliminate trade deficits. The increasing trend in exports earning was followed by imports during the 1980s, hence Turkey continues to run an annual trade deficit of about $2.6-7 billion per year. Secondly, the inflation rate returned to its previous levels and it reached its peak point of 120.7 per cent in 1994. Thirdly, real wages of workers and civil servants declined significantly. In this respect, the income distribution pattern worsened as relative factor shares in national income shifted away from popular sectors (i.e. agriculture, wages, and salaries) to profits, rents, and interest income. Moreover, the Özal government relied heavily on excessive borrowing from abroad which resulted in a very large external debt, the servicing of which consumes more than one-third of the country's annual export earnings. Finally, traditional patronage politics changed little in the 1980s and early 1990s. Traditional sources of patronage politics included SEEs, public banks and public sector contracts in this period. The EBFs were used increasingly for fiscal decentralization and loyalty grants in favour of municipalities and interest groups which voted for or supported ruling political parties.

The economic policy package that was implemented under the military and the civilian governments in the 1980s aimed at the establishment of a liberal market economy in Turkey. The policy aimed, in other words, at 'dismantling the dominant public sector or shrinking the role of the state within the economy'. As the experience of several other countries where there have been similar policy reorientations have shown, this type of market-oriented economic restructuring does not necessarily imply a 'retreating state'. On the contrary, there were cases in which the increase in the

degree of centralisation of economic decision making process has actually contributed to the success of the liberalisation strategy.[10] Turkey is no exception to this. It is possible to characterize the Turkish experience as a step toward the elimination of political distortions of prices in certain areas such as the determination of the exchange rate, the rate of interest, and the prices of the SEEs products. Having said that, what was observed in these areas was not the elimination of state control over price determination, but rather an increase in the flexibility of the prices. That is to say that although the governmental decision is still dominant, the government has become now more sensitive to market forces in the decision making process.

In summary, despite all concerted efforts to dismantle the public sector or reduce the role of the state within the Turkish economy, the public sector did not only remain almost as powerful as ever, but the Turkish state also grew significantly in the 1980s. However, the transformation of the Turkish economy from a closed to an open one has not been only a process of economic change but also political and ideological process which has now been continuing within a democratic system, albeit slower than in the 1980s.

[10] Apart from the cases of East Asian countries, the experience of the British economy under Thatcher also provides an example of this (see Gamble, 1991 for details).

CHAPTER 4: The Political Economy of the Turkish Privatisation

4.0 Introduction

Privatisation in Turkey started shortly after the 24 January 1980 stabilisation programme being a component of the new philosophy of liberal and export-orientated economic policy. The initial impetus towards privatisation originated from dissatisfaction with the performance of public enterprises and the belief that transfer of SEEs to the private sector would improve their economic efficiency. In the subsequent stages other policy aims, namely, raising finance for government expenditure, widening share ownership, and development of the capital markets in Turkey, became more prominent. From its start in 1986 up to date, the notion of privatisation has always been on the government's agenda as well as a heated political theme ever since.

In this context, this chapter will focus on the privatisation of SEEs in Turkey between 1986 and 1996. The next two sections give a brief overview of the legal and institutional framework and objectives of the Turkish privatisation programme. Subsequent sections concentrate on the implementation of privatisation, its implications in a political context and the problems encountered.

4.1 The Legal and Institutional Framework

The procedure, authority and legal framework for privatisation in Turkey were defined in a number of laws and statutory decrees since the early 1980s. The first legal step in the privatisation process was realised through the enactment of Law No. 2983 in 1984. This law provided the Turkish SEEs and their operations the

opportunity to take on actual persons and/or legal entities as partners. It also allowed the right of operational transfer of these enterprises for a determined period of time.

The Law No. 3291 which was enacted in 1986, set the principles and directives to place the SEEs under the scope of privatisation. According to this Act, privatisation takes place either through block sales of shares or through making offers directly to the public. Shares are to be offered first to privatised firm employees, then -in order of priority- to domestic investors, Turkish workers abroad, and lastly to any other investors.

The Decree No. 233 with the Force of Law indicated that the Council of Ministers is rendered as the acting body to execute privatisation procedures of organisations which are wholly owned by the state and fall under the status of SEEs. The Privatisation High Council (PHC) was also rendered as the acting body for the execution of privatisation implementations for SEEs' subsidiaries, associated corporations, operations and operational units as well as public shares in their participations. With the Law No. 2983, the Mass Housing and Public Participation Administration (MHPPA)[1] was established to execute the privatisation programme besides carrying out public housing implementations and the management of the Privatisation Fund (TÜSIAD, 1987; Önis, 1991a; Tan, 1992). It is thought that the decision to link privatisation with housing seems to have been modelled after the British experience where the privatisation of council housing was an important aspect of the British programme.

However, the MHPPA were split into two in April 1991 with Decree No. 414 with the Force of Law. The responsibility of executing privatisation operations and

[1] Since 1986, the terminology which applies to the Privatisation Administration has become increasingly complicated. Throughout this study I refer to the Public Participation Administration as acting body to execute privatisation in Turkey. The PPA became Privatisation Administration (PA) in 1994. To avoid confusion I have included a list of acronyms with this thesis.

directing the Public Participation Fund was given to the Public Participation Administration (PPA). In 1992, with Decree No. 473 with the Force of Law, the Public Participation High Council (PPHC) was authorised to approve privatisation transactions.

Even though more than half of the enterprises that were placed under the scope of privatisation between 1985 and 1994 have been successfully privatised (PA, 1996), there appeared to be a need for adjusting laws and decrees with the force of law which were directly or indirectly related to privatisation. During the first nine years, certain adjustments did not go beyond basic clarifications of certain principles and thus they proved to be ineffective in establishing a strong legal base to ensure effective implementation. Therefore, limitations of authority, regardless of whether in decision making or on implementation, continued to be time consuming and obstructive for the whole process. Other legal problems such as unemployment compensation, anti-cartel laws, non-existence of an adequate legal framework either at the time of implementation or right after the privatisation turned out to be main structural obstacles faced by privatisation in Turkey.

Attempts to modify the Law Nos. 2983 and 3291 to eliminate certain impediments standing in the way of privatisation and give a momentum to privatisation procedures, only added further confusions to the already obscure laws in existence. Hence, the authorisation of new adjustments for the settlement of social, economic and legal adversity, became inevitable.

The government concluded its detailed groundwork to make adjustments in privatisation implementation in 1994. The jurisdictional Law No. 3987 and five decrees with the Force of Law which were based on this Law were annulled by the Constitution Court on July 1994 (PA, 1996, p.2). The Court's ruling blocked the

Government's use of decree powers to push through the privatisation programme. The Court's justification centres on the argument that the powers given to the executive infringe on the constitutional authority of the elected parliament (*FT*, 8.7.1994; *FT*, 13.7.1994).

The government started a lengthy discussion with all political parties and national unions, and took into account the recommendation made by those parties in order to prepare new privatisation legislation. The outcome of these activities was the Privatisation Law No. 4046 which was published and brought into force on 27 November 1994. This new law replaced all the former laws and decrees regarding privatisation in Turkey. With the new law, the PPHC has also been changed into Privatisation High Council (PHC) and the PPA has become Privatisation Administration (PA). The law also allowed governments to use privatisation revenues for general budget expenditures and investments. Currently, the restructuring and sale of Turkey's SEEs are being managed by the PA under the supervision of the PHC which is chaired by the Prime Minister. The ability given to the Prime Minister to control the privatisation process led to accusations that state enterprises continue to be used for political purposes, and that privatisation policy has been overly-responsive to political imperatives. Yet, this point of criticism seems to be ignored by the law (TÜSIAD, 1992). The Prime Minister has indeed a considerable amount of power over the entire process as head of the majority party in the parliament, and Chair of the PHC. Furthermore, he/she appoints the Chairman of the PA, and has control over the other board members of the PA (Tan, 1992; Kilci, 1994).

4.2 The Objectives of the Turkish Privatisation

The Morgan Bank was commissioned to draw up a master plan for privatisation in Turkey. This bank submitted its report in May 1986. Based on the Turkish

government's goals from privatisation, the report established the general principles of privatisation which were going to shape the process of privatisation in Turkey in the 1980s. The report ranked SEEs according to their suitability for privatisation. 'Saleability' was set as the primary criterion which, in turn, was closely linked to the economic viability of the enterprise. Current operating profitability and market potential were identified as the two key indicators of economic viability.

The study of the Morgan Bank concluded that there were fourteen objectives of the privatisation programme in Turkey. Ranking them according to their importance showed that the most important objective of the privatisation programme is to transfer the decision making process in almost half of the economy from the public to private sector in order to make the economy more responsive to market forces. The efficiency and rate of growth in the economy are expected to increase with this process. Development of a capital market by transferring passive savings (e.g. gold and real estate) into active investment in the capital market was the second objective.

Another aim was to increase the quality, quantity, and diversity of the goods and services provided within the economy. It was also hoped that privatisation would reduce the burden of SEEs on the economy and the budget. Raising revenue for the Treasury was ranked surprisingly as the lowest objective of the Turkish privatisation programme (Israfil, 1987, p.20; Morgan Bank, 1986; TÜSIAD, 1992, p.58ff).

According to the Morgan Report, the government's objectives for the privatisation programme are numerous and some are in conflict with each other. Because the various short term objectives are not internally consistent, success in meeting one objective comes at the expense of another objective, and is a product of the power relationships among the various parties. For example, Leeds' observations on the "rhetoric and reality" of Turkish privatisation is reflected in the programme's

shifting objectives. In his concluding remarks on Turkey's privatisation programme, Leeds (1988) states that "The story of Turkey's privatisation effort has been one of frustration, tension between competing national objectives, structural problems of both a political and economic nature, and painstakingly slow progress" (p.174).[2] Although economic efficiency and making the economy more responsive to the market mechanism continue to be cited as the primary objectives, privatisation in Turkey has come to mean little more than an additional source of governmental revenue up to date (PA, 1995b).

But privatisation is more than the divestiture of state-owned assets to raise revenue- it is a multi-faceted agenda with numerous goals, multiple economic actors, and a great variety of implementation techniques (Van de Walle, 1989; Cook and Minogue, 1990). Although competition and efficiency provide the economic rationale for privatisation, these objectives typically suffer during the implementation process. For example, if the government's objectives include maximising the sale proceeds, then it is unlikely that competition will be increased. A concentrated form of ownership may be required to restructure SEEs, but control objectives conflict with the objectives of capital market development and wider share ownership. If wider share ownership is desired, then significant underpricing may be necessary to entice new investors and/or build confidence in government policy, but this reduces sales proceeds. Unions often lobby successfully for job protection, or generous severance

[2] At this point, one might ask whether the military had any role in privatisation as it had in other aspects of the Turkish political economy earlier. As I already discussed in chapter three (see footnote number one), the role of the army in Turkish politics and history is evident with the three military coups. This study, however, has found no direct evidence that the military has been so far an obstacle to privatisation. In fact, what it has been observed is the indirect involvement of the military establishment in Turkish privatisation through the Armed Forces Benevolent Fund (OYAK) which purchased a number of cement plants sold by the Privatisation Administration in the early 1990s. Having said that, it is not clear at this stage whether the military may have any objection to privatisation on national security grounds if a significant proportion or majority of the shares of SEEs in strategically important sectors such as telecom and petroleum, are sold, in particular, to foreigners.

packages that further undermine the revenue-raising objective. Determining the success of privatisation depends not only on the success in meeting the stated objectives (however formulated), but in the resolution of trade-offs among competing objectives.

Governments are no doubt attracted by the prospect of a new source of revenue, but it is not at all clear whether governments should concern themselves with the revenue aspects of privatisation. Privatisation may help reduce the public sector's borrowing requirements which can 'crowd out' private investment, but it also reduces private savings in the short run. Even foreign investment may not be such a boon once the exchange rate effects and repatriation of future profits on bargain-basement sales prices are included.

Privatisation offers a new source of revenue, especially when profitable SEEs are sold, but this does little to reduce public sector deficits and may even lead to increased deficits in the future as the public portfolio loses its profitable operations. Governments tend to be preoccupied with maximising the sales price and in creating the perception that privatisation is successful, and the objective of efficiency is only secondary.

The innovative use of the capital market to build political support is generally credited to the Thatcher administration in the UK. This option, as Cook and Minogue (1990) argue, does not appear to be the case for the developing countries. They claim that "the stock market is not likely to be a vehicle for the implementation of privatisation in LDCs" (p.389). However, it is often stated that developing economies find themselves in a dilemma: if they had efficient capital markets, they could use them to privatise SEEs, but the capital markets will not be efficient until the government liberalises and divests itself of state enterprise. This view can especially

be valid following Britain's argument that 'no privatisation without liberalisation or no liberalisation without privatisation is good' (1984, p.120). Furthermore, it is argued that there are a number of prerequisites for a successful equity market. These can be broadly identified as 1) a stable political environment and growing economy; 2) a sufficient supply of and demand for stocks; and 3) a regulatory framework which protects the investors (*The Economist*, June 1991). Since the Turkish case did not comply with the above prerequisites, the capital market in Turkey continues to be too shallow, thus it is not a viable option for the privatisation of giant SEEs.

4.3 Privatisation in Turkey: Background

As discussed in the previous chapters, the Turkish government was influenced by the winds of economic neo-liberalism that were sweeping the industrialised world in the 1980s, most notably Thatcherism in Britain and Reaganomics in the United States. The Özal government believed, as its counterparts in the western world did, that through privatisation capitalism could be brought to the people. Prime Minister Özal himself explained his party's policy as follows:

> In the model we adopt, the worker is the owner of the company; he also shares in the profits and has a say in its management... Thus, the company would operate more efficiently, and both the enterprise and the employees would benefit from it... Another advantage of this practice is that it would spread the ownership of capital to wide segments of society, and in the process would enhance general welfare (cited in Ilkin, 1994, p.80).

The emphasis therefore was given to the government's political objective of incorporating significant proportions of the middle-income population into the privatisation process. The Motherland Party (MP) government pointed out that the stocks held by the employees of the SEEs would give them a permanent revenue. There was a two pronged aim from this policy. Firstly, it was expected that this would help to extend property ownership to large segments of the society as a part of the

government's programme of 'popular capitalism'. In his speeches Özal described their efforts with the following words:

> The general public's participation in ownership will strengthen democracy; this is economic democracy; it will be the greatest economic reform in Turkey (cited in Ilkin, 1994, p.81).

The MP deputies suggested that the revenue-sharing policy was instrumental in "spreading the ownership of the industry to the masses". Secondly, in the long term, the success of this policy was vitally important for the newly established centre right, the Motherland Party, in order to create an electoral base for its future. In 1984, the government attempted to test demand of the public for state-owned assets in line with its aim to create a 'popular capitalism'.

Even though the sale of revenue sharing certificates (RSCs) was not a genuine privatisation, it constituted the preliminary stage of the privatisation move in Turkey. The underlying motive for the introduction of RSCs was to enable the public to share the operating revenues of the public enterprises engaged in infrastructural activities such as energy, transport, and communications. In response to the fierce criticism from the opposition parties, Prime Minister Özal defend their policy saying that:

> We shall encourage voluntary savings... The bridge [i.e. the first Bosphorus bridge] stands there and our unemployed people merely look at it. That is not acceptable. We shall sell this bridge as well as others. We shall build new ones. They will continue to serve this country (cited in Ilkin, 1994, p.79).

Opposition parties continued to object to the sale of these facilities which, had been 'established with the savings of the people'. Their opposition regarding the sales of these public assets was on the grounds of social justice, equality, and the like. They argued that it would be impossible for the lower and middle classes to buy RSCs since these people were barely able to make ends meet because of low income level and high rates of inflation.

The sale of RSCs did not involve the real transfer of public assets to private firms or individuals but it was rather a method of borrowing for the government, thus it cannot be regarded as privatisation in its narrow meaning. However, the first set of RSCs were issued in December 1984 in conjunction with the first Bosphorus bridge. They were sold out unexpectedly within hours. And then RSCs for the Keban dam and hydroelectric power station in January 1985 and joint-operating revenues of the Keban and Oymapinar power stations were made available for potential buyers. They were also sold in a short time. From the government's point of view, the experience with RSCs was quite instructive and encouraged them to proceed with privatisation in the real sense of the idea (Leeds, 1988; Kjellström, 1990).

4.4 Privatisation Implementations between 1986-1996

There have been 157 organisations placed under the scope of privatisation since 1985. Some of these are fully SOEs while state shares are varied from 5 to 50 per cent in other enterprises (associates and subsidiaries). Later, nine of the companies were taken out of the portfolio for different reasons. There are still 53 companies and some real estates under the scope of privatisation and 35 of these companies have more than 50 per cent state shares (PA, 1996).

Privatisation implementations started in 1984 by initially transferring incomplete plants of the SOEs to the private sector to be completed or to construct a new plant. In this context, six facilities were sold to various investors and nine plants were transferred to municipalities or to public enterprises on book value.

Within the framework of the programme, privatisation gained momentum after 1986. The PPA completed the sale of shares and transfer of 99 facilities of those that were fully state-owned or were participations. 86 of these facilities no longer have

any state ownership. There are still state shares remaining in 13 other organisations which have been partially privatised through block sales, sales to the public, sales on the international markets, sales at the Istanbul Stock Exchange (ISE) and through the sales of assets.

In this part of the chapter, the full list of activities regarding the privatisation in Turkey, in particular since 1988 whether completed or in progress will be presented. The successive tables, figures and charts will show the sequence of privatisation, the sales of proceeds of public enterprises and the public participation as well as buyers, modes of sales, revenues generated through privatisation and other relevant details.

The sale of TELETAS, telecommunications and switchboard company, was the first real case of state divestiture in February 1988 in Turkey. Teletas was a mixed corporation and the government had 40 per cent of the company's shares. The government offered 22 per cent of its 40 per cent shares to sell to the public. The initial results showed that this sale was a success. All the shares were sold out in three hours to over 40,000 shareholders, and over $13 million revenue was generated (see Table 4.3).

During the subsequent month, the performance of the company started to decline in the ISE so did the value of its shares causing disappointment to the investors. However, this failure can be attributed to two reasons. The first one is that the sale took place in a declining stock market, and/or perhaps, the ISE was not then sophisticated enough for handling a major transfer operation such as the Teletas's one. Secondly, the sale of Teletas shares coincided with a deflationary environment, induced by the government's attempts to restabilise the economy after the general elections in 1987. As a result of this macroeconomic policy changes, the state-owned Turkish PTT (the Post, Telephone and Telegraph Agency), the major customer of the

Teletas, had to cut back some of its investment programmes. Following the Teletas experiment, the authorities became increasingly reluctant to proceed with a privatisation drive based on flotation in the capital market. The authorities directed their attention progressively towards alternative modes of privatisation, involving the direct sale of public assets to private corporations.

In spite of the fact that the business community and their representatives such as TÜSIAD, TOBB, ICI and ICC[3] as a whole, had endorsed privatisation in principle, domestic corporations, however, failed to emerge as serious candidates in the privatisation process. Consequently, the authorities increasingly turned their attention to foreign investors as a means of sustaining the momentum of the privatisation drive in Turkey. A new wave of privatisations occurred during the final months of 1988 and early months of 1989, all of which involved the sale of a substantial part of an enterprise to foreign investors.

Again the first two test cases of this type of privatisation were the sale of the ANSAN-MEDA, beverage and bottling company, to Coca Cola of USA and the sale of a number of animal feed plants. The state sold all its 88.3 per cent shares in Ansa, and Coca Cola took over the control of ownership and management of the company. A number of animal feed plants (stakes ranging from 13% to 45%) were also sold mainly to the domestic investors with the method of block sale in 1989 (PA, 1996; TÜSIAD, 1992; Arioglu, 1994; Çelebi, 1995).

The government wanted to speed up the privatisation process and it was assumed that the sale of blocks of shares to foreign investors might have been the most effective way. Therefore, the new wave of privatisation continued with the sale of Çitosan's (state-owned cement holding) five cement plants to the French firm

[3] These abbreviations denote Turkish Industrialists' and Businessmen's Association; the Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey; Istanbul Chamber of Industry and Istanbul Chamber of Commerce respectively.

Société des Ciments Français (SCF) for $105 million. It was also agreed that SCF would undertake a $60 million investment project over the coming three years to modernise the plants. This was followed by the sale of 70 per cent shares of USAS, an airline catering company, to Scandinavian Airlines (SAS) for $14 million in February 1989. In the following years, the government also sold its minority shares in six other companies producing steel, appliances, electricity and cement[4] (Kjellström, 1990, p.30; PA, 1992; PA, 1996). But most of the sales were again concentrated in the cement industry as will be discussed in chapter six. Since 1988, the PA privatised 26 cement plants which were previously under public ownership in Turkey.

In 1993, Northern Telecom of Canada paid $27.8 million for a further 20 per cent in NETAS, telecommunications equipment manufacturer, and increased its share in the company to 51 per cent. Alcatel of France bought 18 per cent of Teletas, the second biggest telecommunications group, for $21 million and increased its share to 65 per cent (*FT*, 25.11.1993; Intermedia, 1995). These two sales made these foreign companies able to build controlling stakes in Teletas and Netas, and position themselves in the market for larger sales. Moreover, these changes in the stake of the shares put Netas and Teletas into a privately-owned oligopoly position in the Turkish market.

The sale of 60 per cent of HAVAS (airport handling services) was realised in April 1993 while the company workers were still on strike. The new owner of Havas, YAZEKS, agreed to make a $14 million downpayment and it produced guarantee letters to pay the remaining $22 million over two years. However, Yazeks wanted to cancel the sale agreement several times because the government and PA apparently did not comply with the conditions of the sale. Yazeks claimed that Havas lost some

[4] These enterprises are notably Erdemir (iron & steel), Çelik Halat (steel cables), Arçelik (household appliances), Çukurova and Kepez Elektrik (electricity generating), and Bolu Çimento (cement) (PA, 1996).

of its important customers to its rival Çelebi, privately owned ground handling company, in the course of the strike. Hence, Yazeks demanded that its former clients should come back to the company. The dispute was resolved when Çelebi finally agreed to return Havas's former clients after intense pressures from bureaucrats and politicians. Moreover, right after the privatisation of 60 per cent of Havas, the government decided to grant THY (Turkish Airlines) authority to offer ground handling services at the Turkish airports. Upon this decision, Yazeks threatened to default on its payments to the PA. It was reported in the press that the president of PA, Mr. Söylemez, defended PA's decision to grant THY a ground handling licence. He argued that this did not represent a violation of the Havas sale agreement and, besides, it would not be used for two years.

At the end of September 1996, the four tables below based on PA data reveal that around 95 SEEs or public participations have been partially or wholly subject to privatisation since 1986. Most of the these enterprises are small companies in which the state had originally minority shares ranging from 5 to 40 per cent . Although it may be the case that the state had some say in their management, these enterprises were originally managed by their Turkish private sector owners even before the state sold its shares. Hence, privatisation entails neither any major change in the management of these enterprises nor in ownership. The second group of companies privatised were owned solely by the state or the state had a major share in them. After their privatisation, the ownership and management of enterprises completely transferred to private hands. This is apparently the case for most cement plants, electricity generating (e.g. Kepez and Çukurova Elektrik), animal feed plants, banking and insurance. Block sales, public offers or the combination of both sales methods were used in their privatisation process.

Table 4.1: Companies Privatised by Block Sale, 1988-1996 (Listing Scope > $10m)

Name of the Company	% of Share Sold	Industry Type	Purchased By	Sales Date	Total Sales Value ($)
ANSAN-MEDA	88.33	Beverages	Atlantic Ind. Ltd.	28.10.1988	13,588,168
ANKARA ÇIMENTO	99.30	Cement	Société Cement Français	08.9.1989	33,000,000
BALIKESIR ÇIMENTO	98.30	Cement	Société Cement Français	08.9.1989	23,000,000
PINARHISAR ÇIMENTO	99.90	Cement	Société Cement Français	08.9.1989	25,000,000
SÖKE ÇIMENTO	99.60	Cement	Société Cement Français	08.9.1989	11,000,000
TÜRK KABLO	38.00	Cable	Nokia-Finnish Fund Ltd.	26.4.1991	11,000,000
GÜNES SIGORTA	30.00	Insurance	Gan International	10.6.1991	18,900,000
IPRAGAZ	49.33	Liquid Petroleum Gas	Primagaz A.G.	27.1.1992	64,066,776
RAY SIGORTA	49.65	Insurance	Dogan Sirketler Grubu	08.5.1992	10,376,455
GAZIANTEP ÇIMENTO	99.73	Cement	Rumeli Holding	03.12.1992	52,695,898
ISKENDERUN ÇIMENTO	100.00	Cement	OYAK-Sabanci	02.12.1992	61,500,000
TRABZON ÇIMENTO	100.00	Cement	Rumeli Holding	03.12.1992	32,551,000
DENIZLI ÇIMENTO	100.00	Cement	Modern Çimento	04.12.1992	70,100,000
ÇORUM ÇIMENTO	100.00	Cement	Yibitas Holding	25.12.1992	35,000,000
SIVAS ÇIMENTO	100.00	Cement	Yibitas Holding	25.12.1992	29,400,000
LADIK ÇIMENTO	100.00	Cement	Rumeli Holding	21.4.1993	57,598,687
SANLIURFA ÇIMENTO	100.00	Cement	Rumeli Holding	21.4.1993	57,405,988
BARTIN ÇIMENTO	99.78	Cement	Rumeli Holding	06.5.1993	20,568,669
ASKALE ÇIMENTO	100.00	Cement	Erçimsan	17.6.1993	31,158,000
HAVAS	60.00	Airport handling services	Yazeks A.S.	17.4.1995	36,000,000
ADIYAMAN ÇIMENTO	100.00	Cement	Teksko A.S.	16.8.1995	52,500,000
KÜMAS	99.74	Mining	Zeytinoglu A.S.	28.9.1995	108,100,000
SÜMERBANK	100.00	Banking	Ipeks Tekstil A.S.	17.10.1995	103,460,000
ÇINKUR	98.80	Mining	K.M.M. Kayseri Maden	22.5.1996	14,000,000
ELAZIG ÇIMENTO	99.89	Cement	OYAK-Gama	12.6.1996	27,850,000
VAN ÇIMENTO	100.00	Cement	Rumeli Holding	12.6.1996	24,500,000
LALAPASA ÇIMENTO	100.00	Cement	Rumeli Holding	14.6.1996	125,890,000
KARS ÇIMENTO	100.00	Cement	Çimentas	18.6.1996	22,250,000
SUBTOTAL					**1,172,459,641**
COMPANIES BELOW SCOPE					74,281,614
TOTAL OF BLOCK SALES					**1,246,741,255**

Source: PA (1996) *Privatisation in Turkey*: PA various documents.

Table 4.2: Companies Privatised by Public Offering, 1988-1996

Name of the Company	PA Share % as of the Offering Date	% of Share Sold	Industry Type	Sales Date	Total Sales Value (US$)	Number of Applications
ERDEMIR	48.65	2.93	Flat steel manufacturer	April, 1990	53,105,711	33,953
ARÇELIK	13.32	5.83	Manufacturing (*)	April, 1990	19,890,196	12,618
BOLU ÇIMENTO	34.50	10.38	Cement	April, 1990	8,268,150	8,157
ÇELIK HALAT	19.42	13.25	Metal products	April, 1990	7,750,179	6,517
PETKIM	99.97	8.09	Petrochemical products	June, 1990	150,617,183	76,119
KONYA ÇIMENTO	39.87	31.13	Cement	Oct., 1990	17,663,979	6,396
ÜNYE ÇIMENTO	49.21	2.86	Cement	Nov., 1990	927,162	281
MARDIN ÇIMENTO	46.23	25.46	Cement	Nov., 1990	9,161,501	1,280
THY	100.00	1.55	Airline	Nov., 1990	4,976,165	2,488
ADANA ÇIMENTO	47.28	34.32	Cement	Feb., 1991	27,958,470	3,355
MIGROS	42.22	36.40	Supermarket chain	Feb., 1991	5,609,246	3,951
DITAS	14.77	2.51	Automotive spare manuf.	May, 1991	219,411	1,263
TÜPRAS	100.00	1.66	Petroleum refineries	May, 1991	6,036,589	15,456
PETROL OFISI	100.00	4.02	Petroleum marketing	May, 1991	14,386,888	17,206
TOFAS OTO FABRIKASI (I)	23.13	0.85	Automobile manufacturing	June, 1991	6,119,572	3,147
TOFAS OTO FABRIKASI (II)	4.46	0.13	Automobile manufacturing	March, 1994	2,824,239	804
TOTAL OF BLOCK SALES					**355,514,641**	**189,636**

Note: (*) Manufacturer of white household durable goods.
Source: See Table 4.1.

Table 4.3: Companies Privatised by the Combination of Public Offering and Block Sale, 1988-1996

Name of the Company	PA Share % as of the Offering Date	% of Share Sold	Industry Type	Purchased By	Sales Date	Total Sales Value (US$)	Number of Applications
AFYON ÇIMENTO			Cement				
- Block Sale	99.60[1]	51.00		SCF	Sept., 1989	13,000,000	
- Public Offering	48.60	39.87		---	March, 1991	8,422,698	12,591
TOFAS OTO TIC.			Automobile distributor				
- Block Sale	39.00	16.00		Fiat Auto S.p.A.	Feb., 1991	13,203,441	
- Public Offering	23.00	1.36		---	June, 1991	966,248	3,147
NIGDE ÇIMENTO			Cement				
- Public Offering	99.84[1]	12.72		---	May, 1991	2,647,286	1,125
- Block Sale	87.12	87.10		OYAK-Sabanci	March, 1992	22,500,000	
ÇUKUROVA ELEKTRIK			Electricity production				
- Public Offering	18.65	5.45		---	April, 1990	38,829,409	22,184
- Block Sale	11.50	11.25		Rumeli Elektrik	Feb., 1993	81,096,791	
KEPEZ ELEKTRIK			Electricity production				
- Public Offering	42.05	8.14		---	April, 1990	9,390,359	8,320
- Block Sale	25.39	25.39		Rumeli Elektrik	Feb., 1993	33,158,988	
NETAS			Telecommunications				
- Block Sale	49.00[1]	20.00		N.T.L.[2]	March, 1993	23,420,915	
- Public Offering	29.00	7.75		---	March, 1993	8,723,623	4,987
GIMA			Supermarket chain				
- Public Offering	54.68	4.15		---	June, 1991	406,902	283
- Block Sale	50.38[3]	94.05		Bilfer-Dedeman	March, 1993	21,787,413	
TELETAS			Telecommunications				
- Public Offering	40.00	22.00		---	Feb., 1988	13,09,225	41,465
- Block Sale	18.00	18.00		Alcatel B.V.	Aug., 1993	21,002,400	
USAS			Catering				
- Block Sale	100.00	70.00		SAS	Feb., 1989	14,450,000	
- Public Offering	30.00	29.99		---	Oct., 1993	15,205,871	4,672
TOTAL PUBLIC OFFERING						**97,682,621**	
TOTAL BLOCK SALE						**243,619,948**	
GENERAL TOTAL						**341,302,569**	**98,914**

Note: (1) The remaining shares held by PA have been totally sold via ISE at various dates; (2) NTL denotes Northern Telecommunications Ltd.; (3) Balance also includes share of Union of Agriculture Sales Cooperatives in the amount of 50.30% which has been sold together with PA's stake (43.67%).
Source: See Table 4.1.

Table 4.4: Companies Privatised by International Offering and Sales of ISE, 1988-1996

Name of the Company	PA Share % as of the Offering Date	% of Share Sold	Industry Type	Sales Date	Purchased By	Total Sales Value (US$)
TOFAS OTO FABRIKASI	21.13	16.67	Automobile manufacturing	March, 1990		330,000,000
TOFAS OTO FABRIKASI			Automobile manufacturing	25.5.1996		1,373,573
THY (Turkish Airlines)			Airline	4.6.1996		615,227
SUBTOTAL FOR ISE SALES						**1,988,800**
TOTAL SALES						**331,988,800**

Source: See Table 4.1.

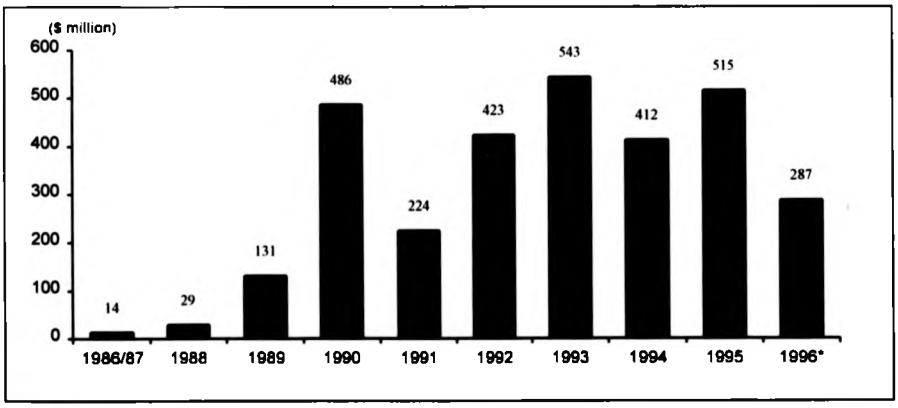
Table 4.5: Companies Privatised by Asset Sale, 1988-1996

Name of the Company	Industry Type	Purchased By	Sales Date	Total Sales Value (US$)
SEK (38 assets and trade mark)	Agriculture	Various investors	1993-1995	68,939,483
YEM SANAYI (30 assets)	Agriculture	Various investors	April 1993-April 1995	21,416,712
SÜMER HOLDING (99 assets)	Textile	Various investors	June/July/Nov. 95-Feb. 96	41,483,862
TURBAN (12 assets)	Tourism	Various investors	June/Oct./Nov. 95-Feb. 96	47,138,512
EBK (17 assets)	Meat, fish, poultry	Various investors	August 1995	41,262,730
PETKIM (2 assets)	Petrochemicals	Various investors	July 1995	2,047,902
DENIZ NAKLIYAT (3 tankers)	Sea freight	Besiktas Denizcilik A.S.	August 1995	12,980,000
ÇINKUR (3 mining fields)	Mining	Various investors	June-August 1995	89,834
SIVAS Dem. Çelik (1 asset)	Mining	Yavuz Özen	September 1995	237,419
KÖYTEKS (3 units and 34 lands)	Investment	Various investors	August 1995-June 1996	1,259,731
TESTAS (Aydin premises)	Electronics	Taiwan Firsthom A.S.	December 1995	1,150,000
ORÜS (8 premises)	Forestry wood material	Various investors	February 1996	19,760,563
POAS (one tanker and 9 lands)	Gasoline/fuel oil market	Various investors	April-June1996	1,504,982
THY (4 aircrafts)	Airline	TopAir/Kibris Turk Airlines	March-April 1996	11,100,000
TOTAL OF ASSET SALES				**270,371,730**

Source: See Table 4.1.

In the present privatisation list, there are more than 53 state enterprises and/or their subsidiaries waiting to be privatised (PA, 1996; Arioglu, 1994, p.34-6). Some of them are the biggest enterprises in the country. Eregli (iron and steel), Sümerbank (textiles, banking and retail outlets), Türban (hotel chain), TDI (Turkish maritime passenger and freight carrier), THY (Turkish Airlines), Petrol Ofisi (fuel marketing), PETKIM (petro-chemicals), TÜPRAS (petroleum refinery) and telecommunication division of Turkish PTT are in the privatisation portfolio and expected to be sold off in the coming years.

Figure 4.1: Privatisation Revenues in Turkey, 1986-1996
Total: $3.1 billion



Note: (*) As of July 25, 1996.
Source: PA (1996) *Privatisation in Turkey*; and various other documents.

Between 1985 and September 1996, according to official data provided by the PA, the privatisation proceeds is equal to $3.1 billion. This includes all the privatisations listed below, privatisations realised during the 1986-1996 period but below $10 million listing scope which usually involve the sale of incomplete units, assets and share sales (PA, 1996). Figure 4.1 above provides data for the privatisation income in the past eleven years. As the data shows in Figure 4.1, it seems that the

amount of revenues generated from privatisation started to increase after 1989 and continued to climb up until 1995, except a slow down in 1991, totalling $3.1 billion in 1996.[5]

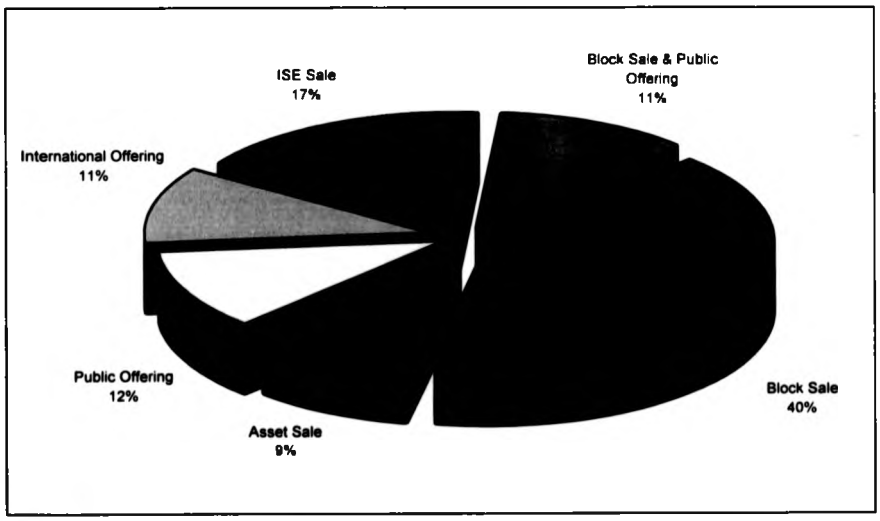
However, the distribution of privatisation revenues by sales methods is presented in Figure 4.2. By September 1996, Figure 4.2 shows that 12 per cent of all sales was realised through public offers in the stock market. The single highest revenue so far was generated from the share offer of Petkim (petro-chemical giant) with the amount over $150 million in 1990 (see Table 4.2). This shows that the sale of big SEEs will make a huge difference both in terms of revenue generated and the number of shareholders in the privatisation process in the country. The sale of 8 per cent of Petkim shares in the stock market attracted over 76,000 investors. The last columns in Table 4.2 and 4.3 show that around 300,000 investors bought the shares of the privatised companies in Turkey. That may not be a very significant figure compared to the millions of shareholders of the privatised British firms (Curwen and Holmes, 1992; OECD, 1996, p.29), but it is still very encouraging bearing in mind the difficulties of an emerging stock market. Further, even though it has not been possible to find an extensive study about the behaviour of shareholders, it seems that the individual investors of privatised Turkish enterprises are pleased to possess their shares. For example, after the privatisation of Teletas by public offer in 1988, 76 per cent of the shareholders decided to retain their shares while only 24 per cent of them sold their shares in 1989 (Duran, 1994, p.110).

For privatisations implemented through share offers to the public, confidence in market institutions and reduction of the problem of adverse selection between informed and uninformed investors must be considered. Some initial underpricing of

[5] This is mainly due to the economic crisis and the Gulf War and its impact on the ISE.

share offers will be necessary to attract uninformed investors, and the degree of underpricing is expected to exceed that of initial stock offers by private firms. The absence of underpricing in Turkey's privatisation offers, and the highly variable initial returns poses a severe limitation on privatisation through public offer. Transparency of operations and non-manipulation of share prices is critical to maintain investors' confidence. Although the Turkish privatisation programme has largely failed in its mission to aid the development of the stock market, it is still encouraging to note that the regulations governing transactions in the market have recently been improved. Further, the volume of trade in the Istanbul Stock Exchange has increased considerably in recent years.

Figure 4.2: Distribution of Privatisation Revenues by Sales Methods, 1986-1996



Note: As of September 16, 1996; ISE denotes the Istanbul Stock Exchange.
Source: PA (1996).

Public offers with a preference for small shareholders provide a very useful mechanism for building political support for market institutions. The public offer mechanism not only promises political reinforcement, but widespread share ownership

increases participation (which was one of main elements of Turkish privatisation objectives), and this is judged essential for democratic, capitalist societies. Many of the ambitious privatisation programmes announced in the 1980s failed to take proper account of inadequate institutional structures, and Turkey was among them. Thus it becomes imperative that capital markets and related institutions should be promoted by the private sector and governments before attempting privatisation through public offers in stock markets.

Block sales appear to be the most commonly used method of privatisation in Turkey. The share of block sales represents 40 per cent in total sales. The combination of the two, block sales and public offerings, represents only 11 per cent. Sales of assets which also includes the sale of incomplete units are only 9 per cent in total revenue raised through privatisation. From the perspective of building popular support and/or dampen opposition, however, the option of block sales has limited appeal. Potential investors include existing private business interests, the firm's employees, and foreign investors. The existing employees are usually not realistic candidates for ownership due to lack of financial resources. Further, if the firm has had to rely on state subsidies, employees are likely to prefer the security of the status quo to the risk of ownership. Sale to foreign investors is usually objected to on nationalistic grounds (Stevens, 1992). As the Özal administration discovered, block sales to foreign interests provides fuel to opposition parties and weakens the existing coalition. Domestic business interests may only be willing to purchase assets on extremely advantageous terms, and this is likely to create opposition over the sales prices (Sariaslan and Erol, 1993). During the interview, one of the PPA officials spelled out why the government was in favour of block sales to foreign investors. He says that:

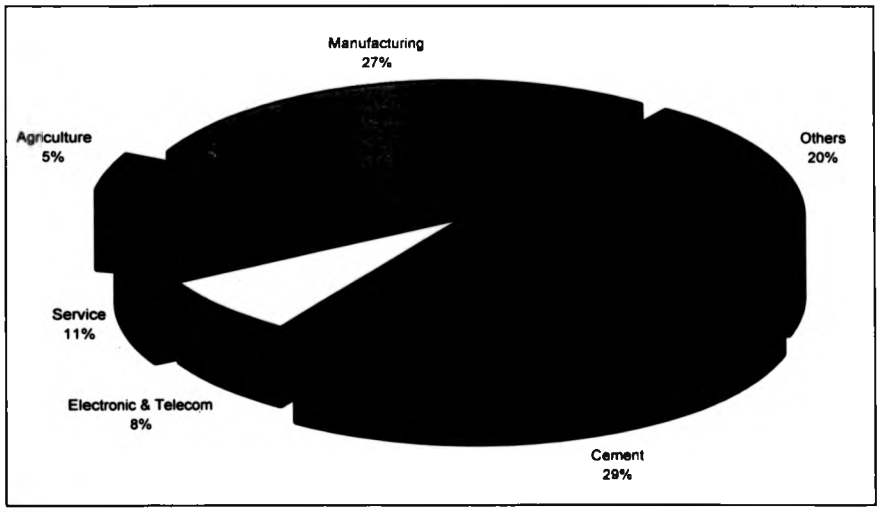
> Most of the bids handed in the PPA by the foreign investors were two or three times higher than the ones delivered by the domestic investors. Hence, it was very logical for us [the PPA] to choose foreign investors if they met the other requirements of the auction (personal interview, September 1995).

Despite this, block sales to domestic investors may be the most attractive options because other options are limited such as lack of foreign investors, and because this block sale offers the best chance for enforcing market discipline on the firm. Although a block sale does little to promote an electoral coalition in favour of privatisation, the efficiency gains can be used to build electoral support. The difficulty is in convincing the electorate that these gains exist, and that the generalised benefits exceed the costs to special interest groups.

The strategy of block sale, however, can especially be attractive where a concentrated form of private ownership is judged necessary for control and to enforce market discipline on the firm. By retaining a significant minority position, the government indicates a willingness to share the financial risk of adverse policy changes. This increases investor confidence against sudden turnarounds in public policy which may affect the privatised industries. It also permits the government to participate in the firm's increased value, and dampens public criticism regarding the sales prices. The only Turkish example which fits this pattern, Afyon Çimento (cement), resulted from the buyers' demands rather than the government's objectives.

The sectoral distribution of privatisation between 1986 and 1996 is given in Figure 4.3. The figure clearly shows that until 1996 the cement industry was the most popular field of privatisation with 29 per cent. Since 1989 Çitosan's 26 cement plants were fully privatised and now they are under the control of private ownership. It is important to keep in mind that the privatisation of the cement and animal feed industries is a relative success compared with other industries in Turkey.

Figure 4.3: Sectoral Distribution of Privatisation Revenues, 1986-1996
Total: $3.1 billion



Note: As of September 19, 1996.
Source: Tabulated by the researcher from the data provided by the PA (1996).

Overall, Turkey's privatisation programme has proceeded quite slowly owing to technical reasons such as the absence of a capital market, but particularly due to political impediments. The selection of cement for the first extensive privatisation results from a combination of push and pull factors which made it an attractive candidate for privatisation as will be discussed in the succeeding chapters (Çakmak and Zaim, 1992).

The second biggest item, manufacturing sector, with 27 per cent was followed by service sector (mainly banking, catering, tourism, marketing) which has 11 per cent in total privatisation realised until September 1996. The other privatised sectors are electricity and telecommunications, and agriculture (animal feeds, dairy industries, meat and fisheries) which represent 8 and 5 per cent respectively in total privatisation income. Nevertheless, it should be emphasised that, according to our estimation based on the data presented in the tables and figures above, around three quarters of revenues

came from sales of minority stakes in private companies, and the rest, which is about $800 million, of the income was 'real' privatisation, mostly in peripheral sectors.

4.5 The New Government and Reform Programme

In the 1990s, the structural problems of the Turkish economy such as rising internal and external debt, high and volatile rates of inflation, and poor performance of SEEs, continued to occupy the government's agenda. The impact of the Gulf Crisis on the Turkish economy brought about further difficulties that needed to be solved. In the context of the public sector, profitability of SEEs worsened after 1988. The rate of sales profitability for the public firms showing profit dropped from average 11 per cent between 1985-88 to 7 per cent in 1991 and then to 4 per cent in 1993 (ICI, 1992; ICI, 1995). The basic reason for this decline was the cost of their increasing domestic and foreign debts. Moreover, the inability of the government to offset public expenditures by taxes also contributed to this rise. The rate of SEEs' borrowing requirements as a percentage of GNP, excluding budget transfers, increased from 2.6 per cent in 1989 to 5.8 per cent in 1991 (Treasury, 1996).

On the political front, the coalition of True Path Party (TPP) and Social Democrat Populist Party (SDPP)[6] came to power with the 1991 general elections replacing the 8 year uninterrupted MP rule. This new coalition government aimed at structuring the institutional and material basis of Turkey's industrialisation within a two-year stability programme. The first thing to be done was reducing inflation to an acceptable level which the MP government had failed to achieve.

Within the programme of the coalition government, the problems of Turkish SEEs and privatisation were emphasised as important issues needing to be dealt with.

[6] They are usually known by their acronym DYP and SHP respectively. SDPP amalgamated and became the Republican People's Party (RPP) in 1995.

During this first coalition government under Mr. Demirel's leadership, the sales of public sector and SEEs' shares continued, together with the introduction of a new "SEE reform" as a part of the industrial strategies. Yet, the success of the SEE reform was dependent on the success of the whole programme (Alkin, 1993; Çelebi, 1995; Shaker, 1995). In reducing inflation, the coalition government was not only motivated by increasing competition in economy, but by establishing the principles of rationality in the public sector as well. The SEE reform was seen as an instrument which would integrate Turkey into the globalised world economy.

The reform was initially based on the principle of a restructuring in management in order to increase efficiency and profitability. This reform being strategic at that time, also introduced other goals like giving autonomy to the SEEs to free them from political and bureaucratic interventions. The aim was the creation of a 'professional management'. Although privatisation of ownership is important, the privatisation of management is also considered as essential. Because it is argued that one of the main reasons for the failure of SEEs has been political interference in the management of enterprise. Thus, giving autonomy to the SEEs with strong supervising mechanism will help them to be run like a well functioning firm in the private sector.

However, the principles of autonomy was the last thing that coalition partners agreed upon. For example, SDPP, always being reluctant about privatisation, agreed on first giving autonomy to the SEEs and then privatising them. Accordingly, privatisation should be used to increase efficiency and competition, rather than with the only initiative of changing ownership whatever the costs would be. Later on, December 1991, all the power and responsibilities about privatisation was given to the PPF together with the transformation of all shares of the state. It was accepted that privatisation would be implemented by the PPA until the autonomous institution,

which was later called as TÖYÖK (*Institution of Turkish Autonomisation, Restructuring and Privatisation*), was established. The revenues coming from the privatisation of the SEEs would be partly given to TÖYÖK and partly to the state treasury for the purpose of using in education, health services and other new investments (TOBB, 1993).

The coalition between TPP and SDPP under the leadership of Mrs. Çiller continued without achieving much needed consensus on important issues such as privatisation even with her partner in the coalition. In the coalition protocol, in contrast to the previous one, there was no reference to any "reform" programme but the rapid privatisation of SEEs. At the end of May 1992, the government decided to privatise EBK (Turkish Meat and Fish Corporation), YEMSAN (Seed Industry) and SEK (Turkish Milk Industry). An amount of TL4-5 trillion[7] was expected from the sales in 1992. But even the achievement of such a small amount seemed to be difficult. This was mainly because of concerned parties about privatisation. Procedural and principle differences seemed to be the first obstacles. TPP's emphasis was on opening up to foreign markets by such sales as well as increasing the exports opportunities. Mrs. Çiller stated her dedication that:

> ... The restructuring programme of Turkey... aiming both to increase its productivity to attain sustainable growth and to make more responsibility in the globalization process. The main target is to reduce the government's role in the economy and more towards greater reliance on market forces. In this context, privatisation programmes have top priority on our economic agenda (Çiller, 1993, p.6).

SDPP on the contrary, gave priority to putting the new technology into effect and 'autonomy' first within the existing conditions of the public enterprises. Furthermore, concerning selling SEEs to foreigners, particularly of strategic ones such as PETKIM and the telecommunications division of the PTT, the SDPP's main reason

[7] It is about $600-750 million.

for objection was that it was against national interest and sovereignty. Social democrats argued that the service and commodity production will result in the benefit of foreign capital rather than domestic capital accumulation. The leadership of SDPP argued that SDPP was not against privatisation rather they were differing on the methods used by TPP. The right wing of the coalition argued that privatisation could be used to control inflation. In contrast, SDPP indicated that using the sale revenues to meet the budget deficit through block sales was against the basic principles of privatisation. Some SDPP deputies even publicly blamed the TPP wing for mismanaging and reducing the concept of privatisation into a "change in ownership".

After the new government protocol with Çiller, problems came to surface about privatisation. The much debated TÖYÖK reform programme, for instance, had to be put on the shelf. When ideological differences and the lack of transparency in decision-making during the course of privatisation were added to the picture, the uneasy nature of the coalition became more clear. While the etatist lobby emphasised the need for preventive measures before privatisation, liberals were committed to divestiture implementations whatever the cost would be (TOBB, 1993). All the above mentioned points led to a slow and time-consuming pace of privatisation in Turkey as discussed in the following section.

4.6 Turkey's Struggle with Privatisation: Politics and Implementation of a Strategy

Turkey's experience with privatisation has been one of slow progress. As shown above, little has been achieved in more than a decade. In this section, the discussion will focus on Turkey's struggle with its privatisation programme. This will help to shed light on why privatisation in Turkey has been slow, and how successive

coalition governments in the early 1990s scaled down the whole process of privatisation into a SEE reform package.

Politicians' strongly worded intentions regarding privatisation have only slowly been translated into concrete results in some economies such as in Turkey (Shirley and Nellis, 1991). Indeed, the actual progress of Turkish privatisation has been disappointing. As one observer puts it 'there is a big gap between rhetoric and reality' up to now (Leeds, 1988). The amount of revenues raised by September 1996 is only around $3.1 billion which is equivalent to about 17 per cent of the total Turkish exports, or approximately 2.3 per cent of the GNP with 1994 prices. This figure, which even government officials admit, is "just a drop in the ocean". The scale of privatisation has not changed the structure of the Turkish economy significantly yet. So far only a small number of SEEs have been privatised. The big SEEs, 'money eating monsters' such as TEKEL (state-run liquor and tobacco monopoly), TEK[8] (electricity), TMO (soil and wheat), TCDD (railways) and 'jewels in the crown' such as Tüpras (petroleum refining), Petkim (petro-chemicals), Erdemir (iron and steel), Petrol Ofisi (petrol products retailer) and Türk Telekom (telecommunications) have yet to be privatised, or only a negligible amount of their shares have been sold to public. As time goes by, SEEs continue to be poorly-managed, overstaffed, highly politicised and a burden on the national budget. It is reported in the Turkish press that the 1996 budget stipulates TL50,000 billion for SEE support which may likely be doubled in actual terms.

However, privatisation has been back on the agenda as the cornerstone of the programme of successive coalition governments in the 1990s aiming to change all that as it was of the MP government in the 1980s. It was hoped that with the change of

[8] It is now known as TEDAS.

government and the new Privatisation Law passed through the Parliament in November 1994, the privatisation of the SEEs would gain renewed importance. Disagreements between the coalition partners, however, delayed any significant progress in privatisation. Furthermore, little was privatised even after the legal framework was put into place. The coalition government planned 20 major privatisations which would raise about $5 billion in its 1995 privatisation programme. But, by the end of the year, the programme could barely raise $500 million.

Today, there are more than 50 SEEs waiting to be privatised. So, privatisation, if it goes ahead successfully, will lead to substantial changes within the Turkish economy in particular when larger SEEs are privatised. It seems likely that this enormous task cannot be achieved without removing the obstacles which have been hampering privatisation efforts since 1986. Some of these problems are related to the already difficult mosaic of the Turkish political system while others originate with the socio-economic realities of the country which determine the orientation of the economy. Clearly, without tackling those restraints, Turkish privatisation programme will not go further than being a highly debated political issue on the government agenda for many more years.

The experience of other countries has shown that a period of political stability and continuity is an imperative element for the implementation of a comprehensive privatisation programme. Under these conditions, political leadership can spare some time for building a solid support for its privatisation programme both within the government itself and on the electoral level. As mentioned earlier, the privatisation of SEEs has been on the political agenda in Turkey for the past forty years. But mainly due to the absence of political continuity, no leader has been able to get and sustain

the necessary support, or perhaps the right circumstances to implement a privatisation strategy until the Özal government.

The effort put by Özal to build up a base of political support for his programme of liberalisation and privatisation was exploited by his opponents in the course of the 1980s, and this exploitation started to threaten Özal's political future. The country went from one election to another which eventually put Özal's party out of office. This political uncertainty created a mentality of '*wait and see*' in the country including among Özal's own supporters. Furthermore, this climate of uncertainty in the political arena directly affected the macroeconomic circumstances negatively.

The prospect for a successful privatisation programme was undermined by a deteriorating macroeconomic environment. Again as successful privatisation cases proved, price stability, positive real interest rates, a policy framework which encourages competition, and realistic exchange rates should exist coherently within an economy. Otherwise, the absence of one of these ingredients, or doubt for its existence in the future will put the implementation of the whole privatisation programme into jeopardy.

Knowing this fact, the Özal government improved the Turkish economy significantly and the economy stabilised relatively after the economic chaos of the late 1970s. Nevertheless, macroeconomic slippages which undermined the economy in the late 1980s and early 1990s were also observed. One of the major reasons was the political-electoral cycles which were mentioned earlier. The second reason was the increased union power of a workforce eager to restore real wages. Özal promised to reduce inflation, but stated targets were badly missed, so Özal softened his promises and started to talk about inflation as a price of high growth. Some analysts argue that Özal's failure to deliver lower inflation and to give greater financial rewards to fellow

countrymen, provoked a conflict between short-term expediency and the long-term viability of the privatisation programme (Ulagay, 1990; Shaker, 1995).

Before each election, the government increased deficits to finance more public-works projects and subsidies, and to cover losses of the SEEs where prices were being temporarily repressed to keep inflation down. After the election, the prices of goods and services produced by public enterprises had to be increased to cover costs which gave a big boost to the inflation rate, especially since the public sector products were often inputs for the private sector. The general election in 1987 exemplified this most clearly. The rate of inflation shot up from 32 in 1987 to 68.3 per cent in 1988.

In the aftermath of the 1989 elections, the MP government made a concerted effort to compete with the TPP in order to enlarge its rural electoral base. A direct manifestation of these efforts involved a striking increase in agricultural subsidies through the traditional instrument of the price support scheme which, in turn, contributed to the growing fiscal instability in the late 1980s and early 1990s. In short, the inflationary environment stopped domestic savings and private investment from acting favourably in the economy. For domestic savings and private investment, in fact, this was not an environment that was likely to instil confidence in a privatisation programme. An expert on the Turkish privatisation also pointed out that:

> Even if political and economic obstacles had been overcome, progress on privatisation would still have been slow due to the technical obstacles in implementation. In particular, an implementation policy which involves share sales through the stock market (personal interview, September 1995).

Indeed, apart from political and economic instability in general, there were also some technical problems such as the shallowness of the capital market in terms of its sophistication and volume of trading in Turkey. As noted earlier, promoting the development of the capital market and broadening public participation in share

ownership were some of the major aims of the Turkish privatisation programme. There has been a great effort to develop the ISE and thus to be able to offer public the shares of SEEs through the ISE since early 1980s. Although the figures show that total trading volume in the ISE increased significantly from about $3.5 billion in 1986 to $23.2 billion in 1994, the ISE is still weak in terms of its trading capacity and institutional sophistication to handle large privatisation share sales compared to the ones in the more advanced industrial economies (Intermedia, 1995, p.14; Stevens, 1992, p.17; TÜSIAD, 1994, p.87). This was proved to be the case in many occasions. When PPA offered a large amount of shares from companies in its privatisation list by using the ISE as vehicle for the implementation of privatisation, the equilibrium of the ISE was altered immediately. On a number of occasions, the PPA even had to buy back some of the shares it sold earlier to stabilise the stock market. Consequently there were fewer options in hand for disposing of state-owned assets.

Moreover, in its later stages, bad publicity about the ISE contributed to set back the government's privatisation programme. Allegations about corruption involving insider dealings, sweetheart deals between government officials and some investors stopped many small investors from participating in share sales in the course of privatisation through the ISE. It is claimed that small investors in particular lost a significant amount of money in share sales as well as their faith on the stock exchange as a result of these alleged irregularities.[9]

Because the ISE suffers from various technical and administrative bottle-necks, since April 1990 a scheme of nation-wide share sales through the extensive network of

[9] For example, it was reported in *Sabah* (a highly circulated Istanbul daily) that the securities watchdog, the Capital Markets Board, was investigating two alleged irregularities: first, that a former head of the PA had done a sweetheart deal with one broker in June, selling it stock in the Turkish Airlines just before earnings announcements tripled the price. The second claim was that the same PA head had given the broker early warning of a cancelled tender for stock in Erdemir (iron and steel) (cited in *Euromoney*, November 1996).

leading commercial banks was introduced by the PPA. The intention was to go back to the original idea of spreading share ownership to the people. Under the scheme, the state minority shares in six profitable companies were sold over a three-week period in 1990. Shares were made available for investors at the most computerised branches of *Is Bank*, a leading commercial bank, and its four offices in Europe. The share sales through Is Bank were a success. The state sold its shares in six companies ranging from 3 to 13 per cent, but retained a small amount of shares in all cases. Nonetheless, sales proceeds totalled around $135 million, and the number of buyers exceeded 91 thousand. The sale scheme was thus also a success in spreading share ownership, but in no case did it lead to a change in ownership control (Kjellström, 1990, p.36-7).

The analysis of the Turkish privatisation also demonstrates that the institutional arrangements were unsuitable and inefficient in particular in the early stages of the programme. Some analysts argue that the centralised structure of the privatisation organisation which encapsulated decisions and implementation within a narrow circle of technocrats, could have achieved fairly successful results if factionalism could have been avoided.[10] Instead, this centralised structure of privatisation helped the growth of favouritism and rent-seeking (Bugra, 1994). Moreover, the PA did not have the institutional freedom and efficient staff to carry out the privatisation programme. Problems emerged with the inability of investment banks to provide technical advice and evaluate SEEs' assets. The valuation of assets was usually subject to lengthy delays because of often poor records and the government's need for accurate valuations to sell enterprises, so that allegations of low sale prices could be minimised. These problems undermined the smooth progress of privatisation. Early attempts to

[10] The official in charge of privatisation resigned in 1990, reportedly following a disagreement with the Ministry and the management over which sales strategy to follow.

ask for foreign assistance and expertise had to be dropped because of harsh criticism (Israfil, 1987; Aysan, 1986).

The procedure of selling an enterprise to private investors appears to be painstakingly long and complicated due to its legal and organisational structure. Hence, it is proposed that in order to carry out its duty efficiently the PA urgently needs the strong backing of the government rather than the harsh criticism and obstacles laid out by the variety of political groups (Arioglu, 1994; Sariaslan and Erol, 1993). The former chairman of PA, Mr. Yaramanci, admitted publicly that "without setting up a very good system, privatisation in Turkey cannot be taken forward" (cited in *Dünya*, 27.7.1994). He also underlined the importance of a solid political support to succeed in privatisation.

In addition, frequent changes at the highest ranks of the Privatisation Administration continued to hinder the build-up of expertise. In the past decade, the PA had 12 different chairmen who also worked with several ministers of state. Each privatisation management followed different types of strategies for the implementation of the programme as well as taking their time to settle in and establishing new set of priorities and new strategies (*Milliyet*, 4.8.1996). What looks more worrying is that, according to a government official interviewed, the PA is becoming a source of political patronage and another public institution which politicians use to create employment opportunities for their loyal supporters regardless of whether they have necessary skills for the job (personal interview, September 1995).

The coalition government of TPP and SDPP found privatisation easier to design than to carry out. The initial intention was to proceed quickly in line with a proposal of the World Bank. The SEEs deemed unviable were to be closed and the SEEs considered privatisable were to be sold rapidly (ASO Medya, 1993). The loss in jobs

resulting from privatisation was to be compensated with social security and early retirement schemes which the World Bank would support with a fund of $1 billion. The entire process was to be supervised by an independent body called TÖYÖK which should obtain full control over the management of the privatisation process (BEYD, 1992). This ambitious plan has never worked out as discussed earlier. In fact, when one examines the TÖYÖK proposal one cannot find any intention of 'privatisation' but rather 'autonomisation' which is an idea just to bring two coalition partners together rather than an idea which will lead to practical results (Çarikci, 1992). In the meantime, the deficit of SEEs continues increasingly to be a burden rather than a source of income. So does the need for a single autonomous agency with a strong political backing for the successful implementation of privatisation in Turkey.

Privatisation examples from other countries also show that one of the most important elements of a successful privatisation programme is the coalition of support from most segments of the society, or public support in general. This appears to be a missing component in the Turkish case. The problems facing decision makers in Turkey seemed to stem from the socio-economic structure and the etatist political heritage of the country, combined with rent-seeking and favouritism behaviour of the bureaucracy. Without a doubt, any proposed change of any status quo will always meet with resistance from those who expect to lose more than they will gain from the proposed changes. Numerous economic reforms since 1980, have met with strong resistance expressed by the opposition parties in the parliament and by local industrialists who formed their own interest groups and were keen to preserve their advantages. This resulted in an extensively politicised social and economic life in Turkey.

In such a society, thus, more is required of the politics of privatisation in order for it to be successful than is the case in a society in which authoritarian rulers make all decisions. Therefore, it can be argued that in a such highly politicised society, such as the Turkish one, privatisation should be perceived as politics, because the merger of economic and political decision requires that. In Turkey, political stability came increasingly into conflict with the ideology of market rationality in particular after the 1987 election. The privatisation programme, as a part of the reform policy package, became an 'overpoliticised' issue over the years. Attempts made to 'depoliticise' the issue were not sufficient enough to get the support of other political parties and interest groups. As a result, privatisation became a very vulnerable issue for the government, open to attack.

By becoming controversial, privatisation turned into an obvious target for the opponents of privatisation on attacking the Özal government on each and every occasion. The assertiveness of the opposition was fanned by its perception that the government was weakening in general and in retreat on the privatisation issue in particular. The attacks of the opposition should, however, be seen in a broader perspective. The opposition parties often made these attacks for tactical reasons and their focus was mainly on the particular methods employed rather than on the overall objectives of the programme. The selection and ranking of objectives of the privatisation and the instruments for their realisation have been under increasing debate.

The members of anti-privatisation lobby were not only in the opposition. Many senior politicians leading various parliamentary factions, local politicians from sites hosting SEEs and other politicians from both left and right have joined the ranks of opposition to the government's privatisation programme. Opponents of the

privatisation know that privatisation will likely dismantle one of the world's most valuable sources of political patronage. Opposition to privatisation has come even from within the government. During his administration, Özal had to contend with most of his own cabinet members who were vehemently opposed to privatisation and who used their political power to undermine the programme as much as possible. The best example of this was the Ministry of Finance which was legally in charge of SEEs. The Finance Ministry resisted government policies that would ultimately reduce its responsibility and lessen its bureaucratic authority. Leeds, for instance, describes this:

> In addition to political and bureaucratic resistance, which has been a predictable irritant in virtually every country where privatisation has been tried, political uncertainty has added to the problems. This uncertainty was inherently destabilizing, and it provided encouragement to the adversaries of privatisation, who continued to hope that Özal would be defeated at the polls and his programme would be derailed (1988, p.29).

There was also tremendous resistance from the management of the SEEs themselves and the workers who stand to lose their jobs. The management of some SEEs openly displayed views that differ from those of the PA. Turkish public sector managers tended to view privatisation as accompanied by a loss of prestige and authority, thus some of them prepared and advocated rival privatisation schemes.[11] Further problems were created by the labour organisations which often prefer public ownership because of job security and higher compensation. They fear that privatisation not only leads to a loss of jobs for their members but also reduces the number of union members as a result of possible layoffs. The work force of Turkish SEEs has been naturally suspicious about what will happen to acquired labour rights under a new, maybe even foreign owner and manager, or in the case of closures as suggested for some SEEs. One trade union official said that:

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[11] The management of PETKIM, for example, suggested to seek joint ventures with foreign firms instead of privatising Petkim partially or completely.

> In state enterprises, there are working people who wonder what is going to happen to them in the future. These [SEEs] are an accumulation of our national wealth. They are built with tax money and for years we have been proud of them as symbol of our nation's prosperity. And now they are being sold one by one. It is not easy to understand why privatisation is so vital, and how it can solve the problems of SEEs which were created by politicians not by employees (personal interview, January 1996).

Through its unions, labour is expressing its increasing discomfort about privatisation and is insisting on measures to safeguard its interests. But such measures could, however, bring about a paradox by discouraging possible buyers from investing in any of the SEEs for sale, which from the government's point of view, reduces the chance of saleability as well as weakens its bargaining position.

One of the aims of most privatisation programmes is to achieve a better allocation of national resources including labour. It is undeniable that in most cases SEEs are over-manned and they will be unable to compete in a free market. With the privatisation process, as experienced in other countries, there will be inevitably redundancies in the short term in Turkish economy. But in the long term, as recent studies show, privatisation does not make workers worse off in general, and the rate of unemployment falls following the privatisation (Galal *et al.*, 1994; World Bank, 1995; UNCTAD, 1995).

For being a sensitive issue, like other governments, the Özal government had to approach privatisation very cautiously for two reasons. Firstly, SEE employees were crucial to his government's support base. Secondly, it was feared that social and political unrest might erupt if severe unemployment and its repercussions emerged as a result of extensive privatisation in an economy where high unemployment rate already is a problem. Although a very powerful political issue in Turkey, the potential unemployment resulting from privatisation has probably been overplayed. The World Bank estimates of SEE overstaffing range from 20 to 30 per cent. Since the number of SEE employees was just over 600,000 in 1991, a reduction of at most 150,000 jobs

would be estimated. While this is a large number of jobs (and ignores any multiplier effects), it represents only 0.2 per cent of the total population and 0.6 per cent of the total employed population in Turkey. Furthermore, this should be considered in the view of the fact that there are about 10-15 million people employed in agriculture with the average income of $500-700 per annum (ICI, 1993, p.16; Arioglu, 1994, p.130). Another World Bank study shows that TTK, a state-owned coal mining company, lost about $6.4 billion between 1986 and 1990. Losses in 1992 worked out to about $12,000 per worker which is six times the average national income. Yet health and safety conditions in the mine were so poor that the miners' life expectancy was only 46- 11 years less than the national average. Thus, the report suggests that "The miners and the government would have been better off if the government had imported coal and paid the miners to stay at home (World Bank, 1995, p.12).

So, the short run costs associated with privatisation must be weighed against the long term losses associated with the continued drain on public resources and inflation. Even Özal who spoke in favour of radical economic reform and reducing the role of government in the economy was hesitant to move ahead with such a programme. Partly as a result of his privatisation efforts within the framework of economic reform programme, Özal's political support started to be threatened, in particular after the 1987 elections, MP's rule became a narrow electoral majority in the Parliament and its credible image among the people was in retreat.

Elements within the private sector that depend on the state-subsidised inputs may also resist a shift away from state capitalism. In particular, some kind of opposition from less competitive Turkish business interests to a strong and expanding foreign presence is evident. Potential beneficiaries are the population at large, who, even if they perceive privatisation as being to their benefit, have difficulty expressing

their desires through either the media or the ballot box. Further, according to a survey, "privatisation could not be explained to the public in Turkey" (*Yeni Günaydin*, 27.10.1994). People in the street believe that they are not informed adequately about what is going on privatisation. The same survey also reveals that only 26 per cent of public agree that SEEs should be privatised immediately, and 41 per cent thinks that some of them should be privatised and some others should not. The survey shows that the majority of the public (62%) prefer the sale of SEEs to employees and public than to domestic holding firms or foreigners.

Since the Turkish public does not understand privatisation, it became hostile to the notion. Besides the fear of possible job losses, the perception of general public about privatisation is that SEEs are sold at significantly less than their true value, and that the proceeds are used for government's cash needs. Moreover, in the view of general public, they are sold to foreigners and usually as monopolies without any regulatory measure to prevent monopolistic pricing practices or cuts in service quantity or quality. This was highlighted by the former chairman of the PA, Mr. Yaramanci, with the following words: "we (i.e. the PA) were not successful delivering the message to the public about the reality of privatisation in the country" (*Dünya*, 28.7.1994). He says that potential gains and losses to the general public from privatisation could have been explained by the authorities in a much better way since the beginning of the programme. Hence, this would have eliminated some of the opposition and confusions regarding the programme. Similar concerns are repeatedly expressed by others. A former high ranking bureaucrat who was interviewed acknowledged that:

> The authorities are not successful in explaining that privatisation is for the benefit of the nation as a whole, not particular narrow interests. This message is very vital, thus it is the responsibility of the government and the political parties to get the message across to the

> public. This will presumably eliminate the misconceptions of the [Turkish] privatisation such as plundering of state assets and foreignization (personal interview, September 1995).

Thus it appears that, according to the PA reports, one of the main problems faced during the privatisation process has been the lack of support coming from the public and media (Kök, 1995, p.201). The reason why there is no adequate support from below and the mass media is the lack of transparency and consistency by the governments, in particular, by the successive coalition governments since 1991. As noted earlier, one of the principal lessons from prior experience is that, every privatisation transaction must be transparent. Transparency can be ensured only through clearly defined procedures, disclosure of purchase price and buyer, well-defined institutional responsibilities and adequate monitoring of the programme (UNCTAD, 1995). To some extent, these are the missing characteristics of the Turkish privatisation programme especially during the implementations of the Çiller government. So, it is hard to find evidence of a trust on the part of society and other politicians in regards to privatisation. Recently, privatisation decisions are still been taken behind closed doors as if the government was in a rush, willing to create swift-privatisation without informing the public and taking precautions. The general complaints focusing on issues like; underpricing, sales to foreigners and block sales are mostly results of Çiller's effort to speed up the process. This gives birth to a feeling of distrust among different strata including the mass media, public opinion and politicians as well.

As a whole the lack of transparency has led to a perception of unfair bargaining terms which have higher costs than benefits. Today, it is difficult to convince the public that nothing happens behind closed doors. Moreover, it can be argued that for the sake of speeding up the process of privatisation, the principles of diffusing

ownership and capital to people in order to prevent monopolies and inequalities in income distribution, has been put in serious danger.

Partly because of the lack of transparency and partly because of the allegations of improper dealings during Çiller's term in office, the support of the media and public appears to be fading away rapidly.[12] The public and the media generally view Çiller's privatisation strategy as "selling the public property by auction". There is a concerted public opinion against the idea of selling SEEs when the government is in need of money. The particular sale of Türk Telekom occupied an important space within the debates of privatisation in Turkey. Media and public oppose the sale of Türk Telekom since after the sale neither the ownership nor the management of the company will change but only the government will raise cash for its immediate needs. This sale is also regarded as paying lip service to foreigners.

However, the most serious challenges to the government's privatisation programme have come from the opposition parties in the parliament. The court cases against the sale of five cement plants and USAS were brought by the opposition parties, led by the TPP. And Çiller's attempts to generate revenues for the budget deficit through privatisation received another blow from the Constitutional Court in 1994. The Court overturned five decree laws regarding the privatisation of SEEs, especially the telecommunications division of Turkish PTT.[13] This latter court case is indeed a very good example of the disunity even within the government itself once again. The application was made by the junior coalition partner, SDPP, with the co-operation of the MP, the party which initiated privatisation policies a decade ago.

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[12] The Turkish Parliament voted to investigate corruption charges against Çiller and her personal finances while the chief prosecution office in Ankara decide to open cases against seven bureaucrats, including deputy chairman of the PA, Mr. Yesilada, on charges of fraudulent conduct in the course of TOFAS (car manufacturer) tender (*The Economist*, 27.4.1996; Intermedia, 1995).

[13] It was separated from PTT and became Türk Telekomunikasyon A.S. (known as *Türk Telekom* now).

What the opposition parties argue is that SEEs that are strategically important on economic and military grounds should be excluded from privatisation and definitely not ceded to foreigners (Stevens, 1992). The same strategy should be pursued for SEEs with monopoly power. The opposition also maintained the view that SEEs that are productive and profitable should not be privatised either. In the specific cases of the five cement plants and USAS sales, the opposition parties used a well-established argument among opponents of privatisation programmes; that the sales prices were disgracefully low and that PPF mismanaged the negotiations.[14] Another charge levelled against the sales is that they have enabled the foreign buyers to constitute *de facto* monopolies. One privatisation expert argues that as a result of well publicised court cases, Turkish privatisation failed to build the confidence of foreign investors and this led to a growing mistrust and resentment for the Turkish privatisation programme among potential foreign investors (personal interview, September 1995).

Until recently, there was neither a regulatory framework for the privatised companies nor any legal arrangement to prevent them from becoming a monopoly in the market. As an important step in the right direction, an antitrust and competition law was introduced as a part of the panoply of regulatory functions in 1994. This competition law is not yet functioning fully because regulatory mechanism and regulations needed are not yet in place. But it is hoped that these will be completed in the second part of the 1990s, so that the markets will be governed by international competition principles which will be applicable to private companies and as well as

[14] Government dismissed these claims and defended its deals. It was explained that Çitosan plants were sold at an average $23 million each which was a relatively good price compared to the price of a similar plant somewhere in Europe, and furthermore SCF would undertake $60 million investment project following privatisation (ASO, 1991, p.104). Regarding the USAS case, government argued that USAS with pre-privatisation structure, was not suitable for sale to private individuals. The company needed new technology and know-how to bring its products and services up to international standards. Government expected that new owner, SSP, would improve the services of USAS as well as undertake new investments up to $6-7 million after the privatisation.

those becoming private through the privatisation process. However, privatisation of public monopolies such as electricity and telephone will require new regulatory bodies and mechanisms.

Some analysts of privatisation in Turkey concluded that privatisation would be difficult to implement because the coalition building potential of privatisation is highly restricted (Önis, 1991b). A supportive environment which will help to facilitate a successful implementation of a privatisation programme does not exist. There has been a major opposition coming from vested interests, from people who will lose their privileged positions either within the enterprise itself or people who obtain cheap goods and services from these enterprises. When the problems of legal and institutional difficulties, and other peculiarities of the Turkish economy are added to the picture, the process of privatisation has become a struggle and the public has come to see it as a cynical game which is getting the country nowhere; that it is leading to the plundering of state assets and foreignization of domestic companies.

From this point of view, Turkey with its inability to pursue a strong privatisation programme in the face of resistance from vested interests presents an exceptional case because the political leadership in other developing countries (e.g. Mexico, Argentina and Chile) faced the same sorts of obstacles but it has been able to overcome resistance and privatised large number of public enterprises. Therefore, Turkey's failure in its privatisation programme may have had something to do with other elements which did not exist in other countries.

As was already mentioned, some of the problems are related to the difficult mosaic of the Turkish political system while others originate with the socio-economic realities of the country. Furthermore, I would argue that so far the outcome of the privatisation in Turkey has seemed to be shaped by the institutionalised patterns of

Turkish policy making and political structure. The significance of this institutionalised political structure became even clearer once long negotiations with several interest groups were started to proceed with privatisation. It was very difficult to convince different parliamentary factions which were representing various vested interests and coming from both the ruling or opposition parties. When one adds this to the ideological differences and the uneasy nature of the coalition during the early 1990s, the process and implementation of privatisation became even more complicated which naturally turned the whole policy into a slow, time consuming activity.

In contrast, in the three countries mentioned above, a different type of political system ('delegated democracy' or 'presidential system') is evident; where power is largely concentrated in the hands of chief executive (i.e. the President) or a small group of people. The legislature in this system is usually weak and can be controlled easily by the President. Hence, it allows the political leadership to push through certain decrees, laws or to speed up the implementation of specific policies like privatisation. In fact, in contrast to privatisation, the degree of centralisation of economic decision making and policy implementation process actually contributed to the success of Turkish liberalisation strategy in the early 1980s under the austerity measures and, to some extent, the authoritarian regime.

It could be argued that Turkish politicians, except perhaps for a few of them, never fully supported the privatisation policy but merely paid lip service to the idea. Moreover, the government's weakness or signs of weakness, in particular since the late 1980s, have encouraged the opposition parties and other interest groups which are against the privatisation of Turkish SEEs. Once they saw that the government was in retreat on the issue, the level of criticism and opposition also started to increase

reaching its crescendo in the early 1990s. Of course, once privatisation stalls in its early stage, as experience in other countries shows, the credibility of the government and its privatisation programme in the eyes of public and domestic and foreign investors is undermined and, it is usually very difficult to gain the already lost credibility and give a fresh momentum to the privatisation policy. If one takes into account the lack of pressure exerted by the IMF and the World Bank for the success of a specific programme as occurred in the case of Turkey's structural adjustment programme in 1980, the privatisation of Turkish SEEs has become an issue which the government and politicians have felt less obliged to carry out.

In 1995, it was hoped that Turkish privatisation would finally get underway. Despite all the hopes and efforts, the coalition government's $60 billion privatisation programme was only able to produce $500 million. This was an insignificant amount of revenue compared to the government's target of $5 billion worth of asset sales for 1995. In fact, the amount raised was so little that it was described as "the mountain has given birth to a mouse" (*FT*, 12.6.1995).

The latest situation is not different than any other year since privatisation started ten years ago. Some optimistic PA officials expected around half a billion dollar of privatisation revenues by the end of 1996 assuming that the coalition partners of pro-Islamic Welfare Party and TPP could agree on the issues related to the privatisation programme, while others found the target too ambitious within the uncertain political and economic climate (personal interviews, September 1996). In 1997, another coalition government which was formed by the MP, Democratic Leftist Party and other small parties has so far seemed to be busy solving socio-economic problems inherited from the previous coalition government rather than concentrating on privatisation.

Today, however, it looks as if the privatisation programme has lost some of its original goals and became a little more than 'a source of additional budget revenues' for the government. This trend started in 1990 when the government realised that the budget deficit was going to increase rapidly. Indeed, mainly due to costly wage settlements, the government budget deficit reached 2.3 per cent of GNP in 1990 from 1.2 per cent surplus in 1989. Similarly, the PSBR increased from 5.6 per cent of GNP in 1989 to 10.5 per cent in 1990 (see Table 3.1). Since the stock market was booming, there appeared to be an opportunity to generate revenues through SEE share sales on the ISE. Even Özal as the President in 1990 was urging the government to go ahead with the privatisation quickly. He said that "If the state wants to close its budget gap then it has to sell shares of its enterprises on the exchange" (cited in Patton, 1992, p.116). This trend has been maintained within the successive coalition governments. Çiller openly talks about the 'sale' of Türk Telekom to generate between $15-20 billion for the immediate needs of the government, so it appears that the notion of 'privatisation' is not on the agenda of the present policy makers, but the 'sale' of profitable state enterprises such Türk Telekom is. However, critics of the sale often warn the government that without any restructuring of the telecom market and/or setting a regulatory framework to promote competition and to increase efficiency, the privatisation of Turk Telecom may be unlikely to bring any significant benefit or improvement to consumers. Thus, the government should not rush into privatising its telecom company without a carefully designed and implemented privatisation strategy.

More importantly, most of the deals done, have either been cancelled or are in jeopardy. The sale of EBK (chain of fish and meat stores) to employees led by their union, Hak-Is, with an extremely low sale price had to be invalidated by the government because of angry opposition from the public. The privatisation of the

Istanbul Dockyards also had to be cancelled at the last minute. The privatisation Administration agreed to grant the dockyard workers' union a 49-year lease, provided that at least half the workers formed a company. Upon the workers' claim that the union bosses had retained most of the shares, the deal was dropped and the docks remained unprivatised.

The sale of other state enterprises, Petlas (a tyre company), Metas, Havas and SEK (milk and dairy products), faced similar serious problems. Even worse, there is an increasing widespread concern over lack of transparency. The existing rigid, inefficient and corrupt organisational structure is seriously affecting the whole privatisation process in the country. Media reports and complaints in the business community about corruption, favouritism, asset stripping by buyers, and ad hoc bidding are threatening to discredit the very concept of privatisation.

4.7 Conclusion

In this chapter, an analysis of the Turkish privatisation has been presented. Evidence suggests that Turkey's privatisation programme has been a pragmatic response to severe political and economic problems resulting, in part, from state capitalism; pervasive rent-seeking, and shrinking state resources. However, the progress of privatisation in Turkey has been slow. The results in terms of the number of companies privatised and revenues generated through privatisation are disappointing, as one official in the Treasury puts it:

> Success of the Turkish privatisation so far has been limited to certain sectors, notably the cement and animal feed. Hence the privatisation programme as a whole has not been very successful (personal interview, September 1995).

The strategy of privatising profitable assets operating in relatively competitive markets such as the cement plants, so far, has permitted the government to raise

revenue without addressing politically-sensitive issues such as regulatory reform. According to the PA which handles the privatisation of SEEs, a decade of privatisation efforts has produced only $3.1 billion privatisation income which represents only 2.3 per cent of Turkish GNP.

In general, numerous explanations for the failure can be offered. The shallowness of the stock market, domestic investors frightened by rampant inflation, foreign investors deterred by the legal complications over the sale of five cement and airline catering companies to SCF and SSP respectively are just some of them. So, too, is bureaucratic infighting.

An analytical assessment of the Turkish experience with privatisation shows that two distinctive factors have affected the strategy and outcome of privatisation. Firstly, the peculiar conditions of the country (i.e. economic, political, and social circumstances) have eventually created either obstacles or an enabling environment for the economic reform programme, and privatisation has been part of this programme. Secondly, the ability of Turkish decision makers to combine political commitment and public consensus and understanding for the reform policies has failed largely due to the important and influential groups who prefer the rent-seeking status quo.

As in many other developing countries, politicians in Turkey have been reluctant to fully embrace privatisation because of its likely sensitive consequences such as unemployment which exposes politicians to criticisms which undermine their chances for re-election. Instead, it has been easier to increase government deficits which adds to the inflationary pressures rather than cut spending, and liquidate unprofitable SEEs.

For the Turkish government, raising cash for the budget through privatisation has become the first objective after being specified as the last in the Privatisation Master Plan in 1986. Earlier attempts to institute a Thatcher style popular capitalism through wider share ownership have been largely forgotten. Reducing the role of the state in the economy by privatising public enterprises has barely begun. The relative role of SEEs has diminished in terms of investment, but not in terms of employment. The sale of minority shares and public assets raises doubts about gaining greater efficiency since this kind of sales neither change the ownership of the company nor make them more competitive.

In the meantime, the performance of many SEEs continues to be poor. In 1994, the share of SEEs in PSBR accounted for more than one third, and most of this went to the subsidies in agriculture, social security systems and the encouragement of certain projects or sectors. Deficits of SEEs remained the second largest component in the total public sector deficit with 2.3 per cent in 1994. The provisional figures released by the Treasury indicate that 30 SEEs recorded a $3.9 billion loss while the remaining 15 registered $685 million profit, bringing the net loss of SEEs to $3.2 billion in 1994. Furthermore, the deficit of six SEEs[15] represented 80 per cent of all PSBR for the public enterprises (Treasury, 1996).

This picture of a poorly performing public enterprise sector has to be changed and its performance has to be improved. Otherwise, one can probably argue that the structural transformation of the Turkish economy pursued since 1980 will remain incomplete and the economy will likely suffer from frequent crises as observed in 1994. One way of achieving this enormous task is to promote the privatisation

[15] The biggest drains on the government budget are the Turkish Iron and Steel Enterprise (TCDI), the Turkish Coal Mining Board (TKI), Turkish Railways (TCDD), the Turkish Electricity Board (TEK), Turkish Soil and Wheat Office (TMO) and the Turkish State Liquor and Tobacco Monopoly (TEKEL).

programme. Even though privatisation is not a panacea to cure all the economic problems of the nation, it is quite possible that a well-designed and well-executed privatisation programme, with its long-term benefits, may help to solve some of the ills of the Turkish economy. The impression gathered during the fieldwork is that getting SEEs out of the government's control will not automatically make the troubled Turkish economy more sound instantly. In fact, it looks that the process is the other way round. But this study argues that the Turkish economy with its existing structural problems may never be healthy and strong, as long as SEEs are still on the government's books and they keep on demanding billions of dollars each year from the Treasury to cover their operating losses.

Thus, this study suggests that at present the most important obstacle to the privatisation programme is the lack of political consensus on the issue. None of the major political parties is against privatisation in principle, but object to the implementation policies employed. Experience of other countries shows that a reasonable level of political consensus among major political parties and main interest groups is a vital ingredient for a successful and speedy privatisation programme. The extent of political consensus or "political will to privatise" as it may be termed, will be determined by politicians' understanding of economics and their willingness to extend democracy to the consumer by recognising that a more competitive environment will likely benefit the community as a whole. Inevitably this implies a willingness to give up the political patronage associated with most state run activities.

In this context, the strategy and calendar of privatisation also depends on political commitment. Once the decisions have been taken as to what is to be privatised, politicians must hand over to an apolitical administration as in the case of successful privatisation cases. The administration itself and its procedures must be

transparent, legally well-backed up and protected to minimise public criticism and most importantly, any political interference that may occur. In Turkey, due to the governments' changing priorities, public enterprises have been easily removed from the privatisation portfolio. This leaves an image behind that the Privatisation Administration is not independent in its decision making and that it can easily be politically motivated.

As mentioned earlier, in order to reach a social consensus it is the responsibility of government and politicians to explain clearly to the public that privatisation is for the benefit of the nation as a whole and not just for the benefit of a few. All of this should be supported by clear actions. For instance, the misconceptions of the Turkish privatisation, ranging from the plunder of state assets to the creation of private monopolies in place of state monopolies or from increases in unemployment to the takeover of local companies by foreigners, should be minimised.

The problems regarding privatisation are also related to the chosen strategy. Instead of stressing the immediate monetary gains and targets in the short term, as Çiller did with her attempt to sell Türk Telekom, the long-term benefits of privatisation such as enhanced competition and efficiency to the economy as a whole should be emphasised by the authorities. Besides, after 10 years of experience with privatisation, Turkey should be already privatising its large SEEs instead of wasting its time with small and strategically insignificant ones.

Most important of all, the Turkish public should be convinced that nothing happens behind closed doors. The public needs to know that things are being done honestly within an environment where the practices of favouritism and corruption are commonplace. Hence, a sufficient level of transparency, accountability and fairness has to be accommodated in the privatisation process. For transparency, this process

must be based on clear principles which are consistently applied and which are not capricious and personal. A fair process does not favour any one method or buyer, but looks to the merits of a particular method or buyer, seeking to take justifiable decisions based on these merits. A fair process will also help to select the method or buyer most suited to the objectives of the privatisation.

It appears as if privatisation decisions in Turkey have been taken behind closed doors in the 1990s. Widespread concern about the corruption, favouritism, asset stripping, lack of transparency and allegations of improper conduct, even at the highest level of administration, are some of the common obstacles which need to be addressed. All these discredited the very concept of privatisation and led to the evaporation of the existing weak social consensus on the issue.

CHAPTER 5: Assessing the Performance of the Privatised Enterprises: A Methodological Framework

5.0 Introduction

The aim of this chapter is to establish a methodological framework for the three empirical chapters to assess the effects of privatisation on the performance of the eight Turkish companies in three different industries that experienced full privatisation during the period 1988-1993. These firms are Çitosan's five cement plants, telecom manufacturers Teletas and Netas, and an airline catering firm, USAS. The impact of privatisation is measured by using micro performance indicators such as profitability and productivity. It is critical to find out the changes occurred as a result of privatisation because the post-privatisation performance of these enterprises will help one to judge whether privatisation has been successful, or whether the companies are better or worse off after it. The chapter begins with a brief review of literature on the impact of privatisation on performance and then it sets the methodology of the empirical study based on the research done by the author.

5.1 Setting the Context for the Study: Literature Review

Despite the widespread implementation of privatisation policies around the world since the early 1980s, the body of knowledge on the impact of privatisation is rather limited. In recent years, however, there have been a number of studies focused on the issue. These studies contributed to the literature on public versus private firm efficiency by measuring the impact of privatisation on companies transferred from the state to the private sector. The economic case for privatisation leading to higher productivity efficiency has already been presented in earlier chapters. According to

this argument, it appears that most governments around the globe adopt privatisation programmes with concrete (and often very optimistic) objectives in mind. One such goal is to raise revenue, but generally the more important objective is to improve the operating and financial performance of the former state economic enterprises by exposing them to market forces. Specifically, almost all governments expect that privatisation will: (1) increase the enterprise's profitability; (2) increase its operating efficiency; (3) cause (or allow) the firm to increase its capital investment spending; and (4) increase its output. In addition, governments also hope that these goals can be achieved (5) without lowering employment levels significantly, but most governments actually expect employment to fall in the short term.

In terms of empirical studies of public and private ownership, the evidence is mixed though generally privately owned firms appear to operate with lower costs and higher productivity in competitive industries. A number of studies about the effects of privatisation are available. One of the early studies by Yarrow (1986), for instance, concluded that in the absence of serious market failures "private ownership is generally to be preferred to public ownership". In another early study done by Bishop and Kay (1988) assessed the performance of twelve privatised enterprises up until 1988. They observed that:

> The overall picture to emerge ... is one of substantial change. Output and profits have grown, margins have increased, employment has declined. But the relationship of these changes to the fact of privatisation is not immediately apparent from the data (p.40-41-45).

Bishop and Thompson (1992) compared the performance of nine enterprises (either privatised or remained in the public sector) in the 1980s with the 1970s. Their findings were that "in aggregate, both labour productivity and total factor productivity have shown significantly faster growth during the 1980s in comparison with the 1970s" (p.1181). Haskel and Szymanski (1993) studied twelve public sector

companies in the UK between 1972 and 1988 and they concluded that privatisation *per se* does not raise productivity and competition is more important.

Most studies in the literature including the ones mentioned above do not consider the effects of macro-economic factors on performance. A number of recent studies (Parker and Martin, 1995; Bishop and Green, 1995), however, take the effects of macro-economic factors on performance into account. This is important because performance improvements in privatised enterprises may simply reflect general improvements throughout a particular industry or in the whole economy in the period studied. Another common characteristic of most of the works cited above is that they examine only a small number of companies from a single country, usually Britain.

It seems that more recent theoretical and empirical studies have overcome this problem and they offer stronger support for the dual propositions that private firms outperform SOEs. Furthermore, privatisation itself increases the operating efficiency of the divested firms. One of these studies undertaken by Boardman and Vining (1989) analyses the relative performance of the 500 largest non-US mining and manufacturing companies in 1983 to determine whether privately owned firms outperform state-owned and mixed state and privately-owned companies. After controlling the regulatory or competitive environment in which each firm operates, they present very strong evidence that private corporations are both more profitable and more efficient (measured as sales per employee and per asset) than either SOEs or mixed enterprises.

The World Bank (1992) attempts to provide a general assessment of international privatisation. Here, they conclude that privatisation has had a positive impact on economic performance, measured in terms of increased investment, improvements in productivity, and output growth and diversification. They also

conclude that economic welfare has improved as a result of privatisation: "the benefits from properly executed privatisation have proved to be considerable, as revealed in cases in Latin America (Mexico, Chile, Jamaica), Africa (Niger, Swaziland), Asia (Malaysia, Korea), and developed countries (UK, France, Japan, New Zealand)" (p.9).

The conclusion drawn in the World Bank (1992) are largely based on a World Bank research study on the welfare consequences of privatisation. The research for the World Bank study was carried out by Galal *et al* (1994), and certainly it can be regarded as one of the most thorough empirical analyses of privatisation. Galal *et al* apply the cost-benefit approach to calculate the net economic welfare effect of privatisation in order to find out changes in welfare, consumer surplus and enterprise profits. The authors analyse the post-privatisation performance of twelve companies (mostly airlines and regulated utilities) in Britain, Chile, Malaysia, and Mexico to determine whether the transfer to private ownership increased efficiency- and if so, how the costs and benefits of adjustment were allocated. Galal *et al.*'s (1994) study documents net welfare gains in eleven of the twelve cases and, on average, the present value of these gains equals 26 per cent of the firm's pre-privatisation sales revenue. Furthermore, they document no case where workers as a class were made worse off and three cases where workers were made significantly better off. This study summarizes that: "so did privatisation make the world a better place or not? Our case studies answer this question with a resounding 'yes'" (p.1).

Despite the fact that the study of Galal *et al* was carefully executed and based on extensive investigation that examined the economic, financial and social welfare implications of privatisation using a before and after approach, it has to be pointed out that the selection of the countries and the number of enterprises used in the study made it difficult to draw global conclusions.

However, an attempt to widen the assessment of privatisation performance to cover a multinational, multi-industry sample of companies is provided by Megginson *et al* (1994). They compare the pre- and post-privatisation performance of 61 companies from 18 countries (6 developing and 12 industrialised) and 32 different industries. The evidence suggests that profitability and operating efficiency increased significantly after privatisation. The study finds no evidence that employment levels fall after privatisation. They present that:

> ... after being privatized, firms increase real sales, become more profitable, increase their capital investment spending, improve their operating efficiency, and increase their work forces (1994, p.403).

Moreover, they noted significant changes in the size and composition of corporate boards of directors after privatisation. The sample of companies is limited to publicly quoted firms that were privatised through public share issues in the period of 1961-1990.

In respect of the Turkish privatisation, Çakmak and Zaim (1992) studied the relative efficiency change in the Turkish cement industry after privatisation, based on a well-established econometric model. They concluded that the transfer of ownership was unlikely to generate substantial improvements in productive efficiency, and that government policy should promote competition regardless of ownership (p.283).

The detailed study of Tallant (1993) in the Turkish cement industry, which is one of the best studies undertaken so far, states that the cement industry privatisations in Turkey have not increased competition and this casts doubt on the prospects for increased efficiency. Tallant's conclusion is that the public sector cement companies in Turkey generally fail to perform at the level of the private sector companies. Further, he found that the capacity utilization rate of public cement companies is lower than private sector cement companies, as is their productivity, and net margin on sales.

The report prepared by the Privatisation Administration provides very useful and detailed data for the privatisation of the cement industry and in particular about the five privatised cement plants (PA, 1994). In their recent study, Suiçmez and Yildirim (1993) examine the performance of the cement industry. They point out that most of the privatised cement plants performed badly on financial terms, but they were able to increase their labour productivity substantially over the years after privatisation. They also suggest that probably due to widespread privatisation in the cement industry, cement firms improved the quality of awareness for environmental protection in their post-privatisation investments.

The study done by Karatas (1995) assessed the performance of the privatised enterprises in Turkey by using profit margins, profit-asset ratios, and labour productivity. Karatas notes an improvement in labour productivity, but consistently poor financial performance for the five cement plants privatised in 1989. However, it needs to be pointed out that Karatas (1995) evaluates the performance of the privatised enterprises only a couple of years before and after their privatisation and that most of them were partially privatised. Further, besides the probable distortions Karatas notes, his work also raises doubts about whether the statistical foundations of his analysis can present the true picture of privatised companies' performance.

Finally, a recent working paper by Saygili and Taymaz (1996) examines the impact of privatisation on technical efficiency in the Turkish cement industry between 1980 and 1993. This study concludes that despite the reduction in the number of employees by 45 per cent in the 3-4 years following the privatisation, so far no significant technical efficiency improvements have been recorded in the cement firms privatised in 1989.

However, the study presented in this thesis differs from the early studies done about the Turkish privatisation in a number of ways. Existing studies in the Turkish context either concentrate on privatisation in only one particular sector, usually cement (Çakmak and Zaim, 1992; Tallant, 1993; Bagdadioglu, 1995; Saygili and Taymaz, 1996; Cam, 1996), or some of them examine the privatisation in a wider context covering several companies in various sectors but they only cover one or two years before and after the privatisation of these particular enterprises studied (Karatas, 1995). Therefore, their analysis may not necessarily reflect the actual picture of the privatised firms in Turkey.

In contrast, this study focuses on the eight privatised companies in three different sectors and covers a ten year period; three years before privatisation and seven years of post-privatisation period. Thus, the findings of this study show more accurately what have happened to the privatised enterprises in Turkey in terms of their performance, profitability and productivity, in the post-privatisation comparing the period with the pre-privatisation and other firms in the same sector where is possible.

Furthermore, in the literature it is frequently mentioned that there is a need for more studies from other countries (especially developing countries) rather than the UK about the impact of privatisation on enterprise performance. So, this study also contributes to the literature to fill this gap by providing a case study of Turkish SEEs and an evaluation of their performance before and after privatisation.

5.2 Methodology of the Empirical Chapters

Sample Selection: The selection of samples used in the case studies included eight companies in three different industries which were transferred from the state to the private ownership. These are Çitosan's five cement plants, Teletas and Netas in

telecommunications industry (telecom equipment manufacturers), and USAS in service industry (airline catering). Therefore, it is not a very comprehensive and a stratified sample selection. The high costs of such comprehensive approach and the limited resources available for data collection and analysis as well as the lack of time for such an immense task, limited the researcher to eight enterprises. The sample is relatively small, non-random and is limited in several important ways, thus it may not be always appropriate to generalise the findings of the case studies to the rest of the privatised enterprises in Turkey. However, the criteria for selection can be explained as follows.

First, all the enterprises mentioned above were privatised in 1988 and 1989, except Netas whose sale was postponed until March 1993. Therefore, since their privatisation there has been a sufficient time to analyse their post-privatisation history. Second, the selected enterprises were privatised by different methods of sale, so if there is any relationship between performance and sale method, this will possibly be observed in this study. Third, in almost all cases, there is a growing trend in terms of demand for the products or services of these companies. In cement, it is expected that, with the increase in the Turkish GNP and population, the demand will increase about 6-9 per cent annually throughout the 1990s. Despite the great steps taken forward in telecommunications in Turkey, the market still promises numerous opportunities in the coming years ahead. Due to the increasing number of tourists and businesses with other countries, the Turkish airline market is also predicted to grow even faster than the cement and telecom industries. Fourth, even though there is pattern of duopoly in the two industries (i.e. Teletas and Netas in telecommunications, and USAS and Çelebi in ground handling and airline catering),[1] in the cement industry private and

[1] This was the case only in the pre-privatisation period because USAS was split into two; HAVAS (ground handling) and USAS (airline and airport catering) before its privatisation. The initial plan of comparing

public sector companies exist side by side before and after the privatisation.[2] Thus, it is possible to make a comparison between them. Though it was privatised in 1993, Netas needs to be examined since it is the second largest firm in telecommunications sector in Turkey. This will widen the understanding of the sector. It will also give one the opportunity to compare the performance of the two firms before and after their privatisations like the cement firms. Moreover, while the cement technology in Turkey has been fairly stable and similar with those in Cembureua[3] countries, the telecommunications technology has undergone rapid change. Thus a comparison is offered between a mature and stable technology and an advanced and rapidly changing technology. Fifth, the cement industry privatisation accounted for about 30 per cent of total privatisation revenues realised between 1986 and 1996 as stated in the previous chapter. There is no argument that privatisation in Turkey has been so far implemented to a greater extent in the cement industry than in any other sector. Hence, it would be difficult to explain not choosing the cement industry for the empirical analysis. Sixth, the USAS case is unique because after the privatisation, it became the only major company in the airline catering services and enjoyed its *de facto* monopoly position until recently. This raises an opportunity to examine a privatised monopoly's behaviour and economic performance in the post-privatisation period in a fast growing tourism industry. Further, these particular privatisations in the cement and airline catering cases attracted public attention due to the publicity of court challenge by the opposition parties.

USAS with Çelebi had to be dropped because these two firms started to operate in different areas of the airline industry in the post-privatisation period. While the former has been engaged in airline and airport catering services, the latter provides ground handling services at the Turkish airports. Thus, any comparison between USAS and Çelebi after 1989 would be rather meaningless.

[2] The cement industry in Turkey is rather competitive in most parts of the country.

[3] The Cembureau members include all the Western European countries plus Turkey, Egypt, and Algeria.

The sample used in this study includes neither the enterprises that were privatised very recently (e.g. Havas, Sümerbank) nor the state enterprises or public participations (joint ventures) that were privatised partially. A small proportion of shares in the nominated SEEs[4], for instance, was privatised by either floating on the stock market or by block sales to private buyers or companies. Furthermore, privatisation in these enterprises is unlikely to create any radical changes in their management, production techniques and pricing policies, because the majority of shares in each enterprise is still owned by the state. Thus, it is difficult to assess the effects of privatisation on enterprise performance when only a small percentage of shares in the SEEs has been transferred to private investors. Nor it is easy to have a clear idea whether public participations or joint ventures have improved profitability and productivity following the sale of some proportions of state shares. But the most important reason not to include these enterprises in the sample is that either the researcher was categorically and effectively denied access to data for these companies, or there was no sufficient and consistent data (e.g. sales, profits, output, number of employees etc.) available which will allow him to evaluate the pre- and post-privatisation performance of these enterprises.

Methodology: Notwithstanding the limitations mentioned so far, the aim of the following three empirical chapters (i.e. chs. 6, 7 and 8) is to find out how the privatised Turkish enterprises performed following the privatisation, and why? It is a very difficult task to assess the performance of privatised enterprises because there is no common and universally accepted 'measure' of performance. Enterprise performance is measured in a variety of ways. One of the common methods of

[4] The share sales of Erdemir (2.9%), Arçelik (5.8%), Petkim (8%), Turkish Airlines (1.5%) and Petrol Ofisi (4%) were just some of the state enterprises in this category. See Table 4.2 and 4.3 in the previous chapter for details.

measuring the performance of privatised firms is to assess their economic efficiency or financial profitability. A range of indicators such as profit margins, profit-asset ratios and labour productivity are used for this purpose.

It is suggested in the literature that besides the choice of performance indicators, others factors should also be taken into consideration. Cook and Kirkpatrick (1995), for example, note that the following two approaches are commonly used for measuring the performance of privatised enterprises. The first is to compare performance before and after privatisation. The second is to compare performance of privatised enterprises to that of similar enterprises that have not been privatised and to take the observed difference as evidence of the impact of privatisation. Obviously, these two approaches may have some drawbacks too because in reality, economic conditions are constantly changing, and therefore any observed changes in enterprise performance could be driven by changes in the economic environment rather than by privatisation.

Therefore, the approach adopted in this study is to compare the performance of the selected enterprises by employing a blend of the methods mentioned above. This study uses various performance indicators such as profit margins, profit-asset ratios and a number of labour productivity indicators. Taking macroeconomic changes in the economy into account may also be very important to explain certain patterns in the pre- and post-privatisation periods, due to the constant instability in the Turkish economy. Thus, the effects of exogenous changes on performance will be pointed out by comparing trends at the enterprise level with trends in the economy.

The study analyses each case by comparing actual performance of each enterprise before and after its privatisation. In most cases, a three year period before privatisation and another seven year period after privatisation are covered. Thus, the

analysis of performance of privatised enterprises covers a ten year period which is long enough to observe any changes brought about by privatisation which other studies about the Turkish privatisation have failed to do so yet. Hence, this study contributes to the literature by examining the performance of these enterprises over a ten year period. In most cases, the study also provides an average figure for a 3 year pre-privatisation (i.e. 1986-88) and another 3 and 4-year post-privatisation periods (i.e. 1989-1991 and 1992-95) to capture 'leads' and 'lags' in performance changes. Hopefully this will assist the researcher to achieve the goal of finding out if there have been any substantial changes in performance, and thereby to identify changes in performance that may have been caused by privatisation.

Using Excel spread sheet software package, the researcher entered a range of statistical data obtained during the fieldwork from different sources such as the Istanbul Chamber of Industry's (ICI) annual regular survey about Turkey's "*500 Large Industrial Establishments*" and "*250 Industrial Establishments following Turkey's 500 Large Industrial Establishments*", company prospectuses and company annual reports where income statements and balance sheet details are provided, reports prepared by different private organisations and government departments, internal memos and unpublished company reports as well as carrying out an extensive survey of newspapers and economic journals. Every effort has been made to ensure that the data for each year are internally consistent, and that the data are consistent from year to year. This range of sources allowed one to compare the findings with the public and private sector when it is necessary.

There was also a need to enter some additional exogenous data such as wholesale price indices, or additional data about the enterprise that were usually not included in the financial statements such as the prices of their products and services,

where applicable, and quantities of major inputs and outputs. The intention here was to put as much detail and economic context as possible in order to clear any doubts that may arise.

Calculation of Variables: In Turkey, as in many other countries, the assessment and measurement of inflation encounter many difficulties, due to both the deficiency of data and the choice of the 'representative' inflation, for instance, wholesale price indices (WPI), consumer price indices (CPI), cost of living index (COL), Istanbul and Ankara price indices[5], and average or end-of-year data. The choice is perhaps less significant for an overall long-term review, but it gains in importance in more detailed discussions of current events, measures and policies, in view of the possibility of substantial discrepancies between wholesale and consumer prices, their differential causes, the annual and monthly price fluctuations and, consequently, the effectiveness of policy responses. Although any of the above indices can be used in converting current prices into constant ones, it was decided by the researcher that the use of *Wholesale Price Index* (WPI) might be more appropriate to deflate all current prices used in this study. The main reasons for this choice were; firstly, WPI is generally considered as more reliable and more indicative for the Turkish macro performance than consumer price index because it covers 1,422 commodities in 636 item groups and it is published regularly by the State Institute of Statistics (SIS), and secondly, there was no continues and reliable consumer price index for the period analysed in this study. However, the exception to this was Table 6.9 in chapter six where cement prices in real terms were calculated. Here instead of using WPI, consumer price index based on 1987 was used.

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[5] Istanbul and Ankara price indices are usually regarded as more reliable but the rates of increase for these two big cities are higher than the country average. Hence, they cannot be good choices for a country wide study.

Without using a price deflator, it was difficult to analyse financial statements of the privatised enterprises and to get an accurate picture of their financial performance. So, by using Excel spread sheet programme, all of the data presented here involved a conversion to constant prices by deflating all current prices with the WPI based on 1981 prices and therefore resulting a far more meaningful set of constant price data.

Some of the important economic variables calculated are presented in Table 5.1 below. These variables stood behind the methodology for the assessment of performance of privatised enterprises. In terms of financial performance, a number of alternative profitability ratios are used to measure the financial returns to the new management of the privatised enterprises. These are: rate of return on sales revenue (ROS) (profit-to-sales ratio), rate of return on total net assets (ROA), rate of return on equity (ROE). The profits-to-sales ratio (ROS) measures the rate of profit accruing per unit of sales revenue of privatised enterprises. On the other hand, ROA is the quotient of management profit to total net assets. The ROA measures the rate of profits resulting from the use of funds in the purchase of both fixed and current assets.

Table 5.1: Performance Indicators

***I. Profitability Ratios*:**
Return on Sales (ROS) = Pre-tax profits / Total Sales
Return on Equity (ROE) = Pre-tax profits / Total Equity
Return on Assets (ROA) = Pre-tax profits / Total Assets
***II. Operating Efficiency*:**
Sales per employee (SALEFF) = Sales / No. of Employees (inflation adjusted)
***III. Productivity Performance*:**
Gross Value Added per employee (GVA) = GVA / No. of Employees (inflation adjusted)
Output per employee (OUTEMP) = Total Output unit / No. of Employees

For the productivity performance of the privatised enterprises, gross value added per employee (GVA), sales per employee (SALEFF) and output per employee (OUTEMP) are used. Output (OUTEMP) for the eight companies in our sample is calculated based on the data recording the physical volume of the output of different goods and services provided by the each firm such as 'ton of cement produced per employee' in cement sector and 'number of meals served per employee' in airline catering. In the case of telecommunications companies, however, there was neither a common physical output nor a consistent and reliable data for various products manufactured by Teletas and Netas such as telephone units, multiplex systems, nationwide grids and exchange systems. It was originally planned to include total factor productivity (TFP) in the assessment of productivity performance, but neither the data available nor the information provided by the privatised companies and the PA enabled the researcher to calculate TFP.

However, given the limited availability and reliability of quantitative data and the current dynamics of the privatisation process, the study also had to rely on alternative sources of information, hence using interviews was another aspect of the methodology used in this study. During the fieldwork, a total number of 27 semi-structured personal interviews were conducted with company representatives who held different positions, PA officials and several other individuals who were in a position to provide relevant information and solicit their opinions and comments regarding privatisation, performance and other matters examined in this study (see the list of interviewees).

It was decided to use the 'semi-structured' (also called 'semi-standardised') interview method. This method allowed the researcher to ask certain, major questions in a similar way in each interview within the framework developed, but it also

provided an opportunity to alter their sequence and to probe for more information based upon what seemed most appropriate in the context of the conversation. It was also possible to change the way questions were worded, give explanations, leave out particular questions which seemed inappropriate with a particular interviewee or to include additional ones if necessary. Questions were usually open-ended so that the interviewees could discuss the issues more freely, and this also offered the researcher the possibility of modifying the line of enquiry, following up interesting responses and investigating underlying motives in detail.

The majority of the interviews conducted lasted approximately 45-60 minutes and besides taking notes, a tape recorder was used which allowed me to record detailed and accurate accounts of the interviews. When a tape recorder was used, the tape was transcribed as soon as possible after the interview. However, one of the minor problems faced regarding recording was that some interviewees, especially a small number of government officials, showed signs of discomfort about talking freely in the presence of a recording device, in particular, where sensitive issues were discussed. So, the tape was stopped to let the interviewee speak "off the record" on some occasions.

These interviews were not always easy to arrange, but, contrary to expectations, the majority of interviewees were generous enough with their time, and they were co-operative. There were a few interviews in which it appeared to be quite difficult to obtain co-operation from interviewees, particularly when specific questions or sensitive points were raised. However, the interviews helped the interpretation of the preliminary findings of quantitative analysis where appropriate and they provided me with otherwise unobtainable information on different issues discussed in this thesis. Most interviews were especially very helpful in assessing the performance of the

privatised enterprises, determining the perspectives of professionals, officials and unions on the issue as well as facilitating the exploration of the factors which account for the specifics of Turkish privatisation programme. Even though the interviews constituted an important part of the primary data, probably as important as the quantitative data, for the analysis made, it might be wondered why reliance could not be placed on the interviews alone rather than the combination of quantitative data and the interviews.

The main reasons for giving an approximately equal importance to both methods can be explained as follows. Data collected from the interviews tended to be qualitative rather than quantitative which, to some extent, brought about some conflicts on points of fact, or interpretation of certain issues discussed during the interviews. Furthermore, it was confirmed in the course of the field research that not all the officials, managers or experts who were involved in one area of privatisation and were interviewed, had a good understanding of privatisation as a whole. Hence, some of the interviewees (e.g. enterprise officials and bureaucrats) avoided the questions asked tactfully, gave inappropriate answers or made claims which were difficult to support with evidence. Where this has occurred or when there were doubts about any information given, without any distortion, I either tried to distil the judgements, points or facts from the other sources available and then tried to weigh up their accuracy.

Therefore, the way in which interviews have been reported in this study may raise concerns about biases and reliability. It is difficult to rule out the fact that there can be biases. There is always a danger of bias creeping into an interview, largely because, as Selltiz (1965, p.583) points out, "interviewers are human beings not machines", and their manner may have an effect on the informants. However, having

said that, every effort has been made in this study to be as neutral as possible both during the interviews and the analysis of the interview data. As an interviewer, the researcher neither sought to influence or reinforce the interviewees' points of view, nor appear to explicitly share his/her views. The views expressed by the interviewees were reflected in this study in as objective a way as possible provided that they were relevant to the issues discussed and the analysis made.

It should be noted that on the whole interviews proved to be very helpful and without the information obtained through the interviews, it would probably not be possible to explain some of the initial but important issues and to formulate the factors which appear to be important for the performance analysis made and for Turkish privatisation in general. For the analysis of this study, financial statements of the companies studied and the interviews conducted are the primary sources of information and they complement each other as the basis of this research study. The combination not only improves the quality of the analysis done but it presumably helps to reduce the weaknesses in the other method and minimise the potential problem of reliability or falsifiability of interviews too.

Nevertheless, anyone who attempts to evaluate the effects of privatisation on the financial performance of the privatised firms in Turkey will have to face some immediate difficulties. Moreover, it is very important to note that all financial ratios used in this study may be subject to the following shortcomings.

Firstly, even though the situation has been changing since the early 1980s, accounting standards in Turkey are rather weak. Moreover, different accounting practices are followed by the public and private cement companies. Secondly, information is not available for some companies in certain years. It is thus a difficult task for researchers to obtain data on a consistent and comparable basis for pre- and

post-privatisation for all items required. Even when information is available, important problems still remain because of the chronic inflation in Turkey, lack of inflation accounting, varying methods of depreciation and so on. Thirdly, the social objectives of public enterprises may not be taken into account in all the profitability ratios. Fourth, in non-competitive market conditions high financial profits may not genuinely reflect an efficient enterprise operation, but high profits may simply result from 'above normal profits' being made because of the firm's monopoly powers. Thus, differences in market outlook, competition and regulation may have an impact on performance of firms. Fifth, financial profits fail to take into account the implicit subsidies like tariff concessions granted to the public enterprises. Therefore, while financial performance may be indicative of privatised enterprise efficiency, it should be used with some reservation in evaluating public enterprise performance. The sixth reason is that it is also difficult to separate out the effect of institutional change from other background factors. Finally, there is a rumour that the pre-privatisation period to some extent involved laundering of figures by capital reconstructions, which may reduce the comparability of performance figures in the pre- and post-privatisation periods.

In summary, the sample used in this study can be regarded as relatively small and non-random which, to some extent, prevents one from extending the findings of the study to the rest of the privatised enterprises and arriving at a general conclusion for Turkish privatisation. There are also the above mentioned concerns regarding the quantitative and qualitative aspects of the data obtained in Turkey. However, in view of all these difficulties, the task is, first, to determine those measures which are both the most useful for the given objectives of the study and also the least subject to distortion, and secondly, to shed some lights on the performance of privatised

enterprises. The analysis is based on the use of ratios and the comparison of these ratios across firms. With regard to the use of the above outlined methodology and sample selection, it may be easy for critical readers to dismiss the results as having too little basis in hard data. Though this argument is understandable, it may be contended that caution is needed in interpretation of all financial and productivity performance figures presented in the empirical chapters due to the limitations and reliability of data. This study is an attempt to do as good a job as possible in an environment with just a few data points, therefore, the study may not be able to present solid and clear-cut evidence for the Turkish privatisation. Arguably, there is something of value to be learnt from the case studies. The next chapter begins with the case study of the cement industry and the relative performance of five cement firms privatised in 1989.

CHAPTER 6: Privatised Firms in Competitive Markets: The Case of Five Cement Plants in Turkey

6.0 Introduction

In the previous chapter, the objectives of the empirical research study were defined and the fundamental criteria and methodology which would guide the choice of research methods to be used were presented and discussed. This chapter first examines the Turkish cement sector and its privatisation. The main aim of the chapter, however, is to analyse the effects of privatisation on the performance of the five privatised cement plants within the methodological framework set in chapter five. The analysis focuses on the performance of privatised firms in terms of efficiency gains and improved productivity, and it tests the claims that privatised enterprises have improved their profits because of freedom to pursue commercial objectives and to adjust themselves to a competitive environment.

6.1 The Turkish Cement Industry: Background

The history of the Turkish cement industry dates back to the early 1910s. The first cement plant in Turkey was built in Darica, near Istanbul with a modest production capacity of 20,000 tons per year in 1911. It was a privately-owned plant and today it is known as Aslan Çimento. Following that, a small publicly-owned cement plant, was established near Ankara in order to assist the development of the new capital. Privately-owned Zeytinburnu and Kartal (presently known as Anadolu Çimento) both serving the Istanbul region started their production with an annual capacity of 25,000 and 85,000 tons respectively.

The publicly-owned cement plant in Sivas began its production in 1943, and was followed by the construction of two privately-owned cement plants in Izmir (Çimentas) and Eskisehir. By 1956 Turkey had a total clinker production capacity[1] of 1.25 million tons per year. The clinker production capacity of state-owned plants accounted for 22 per cent of the total. The Turkish cement sector of the mid-1950s can be characterised as predominantly under private ownership with private cement plants serving the major population centres of Istanbul, Izmir and Bursa. Exceptions to this were a private plant in Eskisehir and a state-owned plant in Ankara. The plant in Eskisehir is located half-way between Bursa and Ankara and serves both markets. The state-owned plant in Ankara was part of the state's development programme for the new capital and interior of the country (SPO, 1993).

In accordance with the great changes that took place in Turkish politics and economics in the 1950s, the state undertook basic industrial development including the construction of the next 13 cement plants all around the country mainly with financial assistance provided by the Marshall Plan. The Turkish Cement Corporation (*Türkiye Çimento Sanayii*, also called *Çisan* or *Çitosan*) was formed in 1953 as a public corporation. During the 1950s the Turkish Cement Corporation (hereafter Çitosan) was run like a private concern, and investment decisions were based primarily on profitability and return on investment (Walstedt, 1980). The state-owned plants built during this period include Adana, Afyon, Çorum, Trakya (also called Pinarhisar), Balikesir, and Elazig, and most of them were among the first to be privatised.

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[1] Cement production occurs in two basic distinct operations: a kiln operation for the production of clinker, and a grinding operation for the production of cement. In the cement sector, both clinker and cement production capacity are used. Some firms tend to prefer citing their clinker production capacity since clinker does not require protection from climatic conditions and is easier to store and transport than cement.

The results of the changing political and economic situation in the 1960s were dramatic in Turkey. The economic model of state planning and import substitution industrialisation (ISI) was introduced and state-led development of under-developed regions started. Çitosan became a SEE, its capital was increased, and this increase was subscribed to the Treasury. The period of ISI gradually led to increased state investment in basic industries including the cement plants in Bartin, Nigde, Trabzon, Van, Askale, and Kars. By the time the next private plant began production in Bursa in 1969, the state sector accounted for 3,460,000 tons of Turkey's total clinker capacity of 4,795,000 tons. Whereas in the mid-1950s the state sector accounted for only 22 per cent of installed capacity, by the end of the 1960s it accounted for 72 per cent of its capacity. The price controls which went into effect in 1958 were not completely lifted until 1985. Moreover, most of the investment decisions of the 1960s and early 1970s were based on social and economic development goals in addition to strictly economic profitability.

Consequently, the cement industry expanded rapidly during the 1970s, more than doubling its capacity to a total clinker capacity of 18.5 million tons per annum. Between 1969 and 1980, 16 cement plants began operations. Additions to the state-owned plants included small facilities in Van, Kars and Askale in Eastern Turkey and the grinding-only facility in Iskenderun. The '*mixed*' sector plants[2] in Ünye, Bolu and Mardin began operations in 1974-75. The nine private plants constructed during this period represented an increase in capacity of 7 million tons. By 1980, the state sector accounted for 6.3 million tons, or 34 per cent of the 18.5 million tons of installed clinker capacity. Immediately prior to the first cement privatisations, the Turkish

[2] In a typical '*mixed*' cement plant, a slim majority of the company was owned by either institutional investors such as OYAK (Armed Forces Benevolent Fund) or private investment groups, and the remaining minority shares, usually around 30-40%, were held by the state. Bolu, Konya, Ünye, Mardin, Adana Çimento are some of the mixed cement plants in this category.

cement sector had a total clinker capacity of 21.6 million tons per year in 1987 produced by 39 cement plants. 21 of them were belonged to the state-owned Çitosan whilst the mixed and private sector had 5 and 13 cement plants respectively. The state, mixed and private sectors accounted for, 38, 16, and 46 per cent of 21.6 million cement production capacity respectively (SPO, 1993; PA, 1988b). All this was against a background of expansion in urbanisation and infrastructure projects in a rapidly developing country context.

6.2 The Turkish Cement Sector Prior to Privatisation

The cement industry just before privatisation can be characterised as follows. The public plants tended to be smaller with an average cement production capacity of 427,000 tons per year versus 745,000 tons per year for the private cement plants in 1985. The average size of the mixed sector plants is about the same as for private sector plants at 732,000 tons per year. All cement plants built since 1963 utilise dry-process kilns. Since most public cement plants were built in the 1950s, the state sector contained a large share of the older technology, wet-process plants (Sema-Metra, 1986).

After 1974, some plants were converted to dry-process kilns from wet-process ones but four cement plants still continued using the wet-process.[3] Tallant (1993) considers the type of technology used as one of the efficiency differences between the public and private cement plants. He also mentions that cement ownership and size is highly correlated with geographic location in the Turkish context.

The cement plants in the Marmara, Aegean, and Mediterranean regions tend to be large, privately-owned plants, while those in the interior of the country, the Black

[3] The oil shock was one of the reasons to force cement plants to change their old technology into dry-process kilns which is cheaper since less energy is needed.

Sea region tend to be state-owned. As will be discussed later, this pattern is also reflected in the profitability and sequence of privatisation of the cement industry. The most profitable state-owned plants tend to be in the western or other high-growth regions, and they were among the first to be privatised. Privatisation of the cement industry has generally progressed from West to East, and from the more profitable to less profitable companies.

The analysis of the regional patterns shows that the Marmara Region accounts for approximately half of all cement production. The cement plants in this region are both more numerous and larger in size of production capacity than in other regions (see Figure 6.1). These cement firms serve the very large, and still rapidly growing, Istanbul market, which presently accommodates around 10 million people, as well as other fast-growing areas around the Sea of Marmara. Furthermore, many of these plants are close to port facilities and they are among Turkey's most important exporting cement companies such as Aslan Çimento, Çimsa, Çanakkale Çimento and Adana Çimento (SPO, 1993, p.55). The less developed regions such as the Black Sea, the Eastern and South Anatolian Regions are served almost exclusively by publicly owned and mixed sector companies. Other regions, such as the Central Anatolian Region, are served by public, private, and mixed sector companies. Here again, the pattern is for private companies to be located near large, fast growing cities, principally Ankara; and for the public sector companies to be placed in less developed areas of the region. The regional breakdown of production also indicates that about 75 per cent of the total production is from the western plants (Çakmak and Zaim, 1992, p.275).

The demand for cement in Turkey has grown at an average rate of 7.1 per cent per year since 1980. Investments to increase production capacity led to a surplus in

supply which is higher than the increase in demand. It is estimated that there is a fairly stable excess capacity of around 20 per cent. There is, however, great regional variation in supply and demand. Generally, the less developed regions are supplied by state-owned firms with significant excess capacity. The rapidly growing western and southern coastal regions are supplied by private, mixed, and a few public firms (Sema-Metra, 1986).

The growth rate for cement demand is three times higher than the annual population increase of 2.2 per cent per annum, and also, is faster than the average GNP growth rate of around 5 per cent per annum during the 1980s. It is clear that the demand for cement is a function of population increase, rate of urbanisation, and the large number of infrastructure projects associated with a rapidly developing economy. Turkey has made the transition from a net importer to a net exporter of cement, although the volume of international transfers is usually small except for a few years of high exports by a handful of large private companies. The SPO figures (1993, p.55-61) show that the total cement export was 2.8 million tons in 1992 compared to 235 thousand tons in 1988. In financial terms, this represents $80.7 million and $6.7 million respectively.

The year 1985 is a useful benchmark for the analysis of the cement sector in Turkey. Besides the liberalisation of cement sale prices at the end of 1985, Turkey's population surpassed 50 million in that year, and for the first time just over half of the population (53%) lived in 'urban' areas. The 1992 and 1995 population is estimated at 58.5 and 62.5 million respectively with a rate of average increase of 2.5 per cent per year (SIS, 1996). The rate of urban population increase is more than twice as great at 5.4 per cent per annum owing to migration from rural to urban areas. Thus it is estimated that the percentage of population living in urban areas will be over 60 per

cent in the early 1990s. Therefore, the potential demand for cement in Turkey is very large. The per capita consumption of cement in 1992 was 443 Kg/person, compared with 770 in Italy, 663 in Spain, and 739 in Greece. Consumption in the more developed countries is even higher. France, Germany and Britain have consumption rates of about 1000 Kg/person (SPO, 1993, p.106).

A comparison with other countries shows that Turkey ranks fifth in terms of total production among the Cembureau countries, and last in terms of per capita consumption (SPO, 1993; PA, 1988b). Although Turkey is a major cement producer, per capita consumption of cement remains far below that of more developed countries. The domestic market analysis indicates that the cement sector has a large potential for growth and profitability. However, the demand for cement is not uniform across the country. Demand is greater in the more developed areas, and imports are periodically required to meet demand. In other areas, such as the Eastern and Southern Anatolian regions, there is a persistent excess capacity. However, the high cost of transporting cement from the regions of excess supply to where there is excess demand often exceeds the cost of importing cement from other countries.

This point is clearly emphasised in the Sema-Metra Report (1986). The findings of this report suggest that the demand for cement in Turkey is very much correlated to the GNP and the population, and it is expected to remain so. The prediction that future demand is expected to closely follow GNP is also made in the *Morgan Guaranty Privatisation Master Plan*. The Sema-Metra Report further estimates that demand for cement in terms of per capita consumption in Turkey is likely to rise approximately 6-9 per cent per year through the 1990s due to increases in population and GNP which are also expected to increase by 5-6 per cent per year and 2.5 per cent per year respectively through 1990s. Having said that, it is a very difficult task to

predict the cement demand accurately because the rate of increase is highly variable from one year to another partly due to the unstable macroeconomic conditions in Turkey (Sema-Metra, 1986; Morgan Bank, 1986).

6.3 Privatisation of the Cement Industry

The Morgan and the Sema-Metra Reports recommended that Çitosan's profitable holdings in the western regions be sold, and that those in the Eastern regions be retained until they could be made more attractive. This basic pattern of the Morgan report was reflected in other sectors as well: profitable operations were considered good candidates for privatisation while unprofitable ones were not. Little consideration was given to how the government's portfolio of loss-making enterprises was to be financed once the ability to transfer funds from profitable operations within SEEs was eliminated.

The *Turkish Cement Sector Restructuration Project* by Sema-Metra Conseil provides a detailed analysis of the state-owned cement industry immediately prior to privatisation. Therefore, frequent reference to this report will be made in subsequent parts of the chapter because it is among the best sources of data for the period up to 1985. The Sema-Metra Report found that the cement industry was a good candidate for privatisation and recommended that Çitosan be sold on a plant-by-plant basis. If sold as a single entity, an 'unhealthy monopoly' would be created in the Eastern areas, and this was not recommended. Like the Morgan Report, the Sema-Metra Report pointed out "the possible increase in regional monopoly concentration which might result from privatisation" for both the western and eastern plants (1986, p.40). The Morgan Report on privatisation recommended that the western plants be privatised in the short-term, and that the eastern plants be privatised after the recommended restructuration. But the Morgan Report suggested that if Çitosan's western plants

were sold to competing Turkish companies, the government "should implement policies which encourage rather than discourage competition" (1986, p.42). Moreover, Sema-Metra found no cement plants so badly run or so unprofitable that a closure was necessary. Most of Sema-Metra's recommendations have been carried out except the recommended measures against the creation of local monopolies which have not been followed, and the speed and extent of the rehabilitation process has lagged.

During the 1980s the public and mixed sectors produced 40-45 per cent of the total cement. For example, just before the privatisation in the cement industry, the state cement holding company, Çitosan, with its 22 cement plants had 32.3 per cent of total cement production in the country. The privatisation of Çitosan can be analysed in three different stages. The first stage is the 1989 block sale of virtually 100 per cent ownership in four plants, and 51 per cent ownership in a fifth cement plant to Société Ciments Français (hereafter SCF). The second stage is the sale of cement plants through public offers which includes the mixed sector plants. And the third stage covers the block sales to domestic investors realised between 1992-1996. Since the privatisation of five cement plants in 1989 is the subject of the following section, it may be rational to give an account of the privatisations of other cement firms between 1990 and 1996, sold by both public offers and block sales.

As Table 6.1 shows, four cement companies (Bolu, Konya, Ünye and Mardin) were offered during the bear market period of the Gulf War. Very few private offerings were made during this period, and the PPAs offerings have been explained as a confidence-building attempt. It can be argued that the government's desire to raise cash overrode any concerns about market timing and confidence-building. This pragmatic approach became clearer with 22 public offerings between April 1990 and

June 1991. Eight of these offerings were in the cement industry (Bolu, Konya, Ünye, Mardin, Adana, Afyon, and Nigde) with the total revenue of just over $75 million (see Table 6.1 and 6.2). Except Nigde, all were 'mixed' sector cement companies. The Armed Forces Benevolent Fund (OYAK), for instance, owned half of Adana, Bolu, Mardin and Ünye Çimento.

This experience showed that the mixed sector companies were relatively easy to sell because the state held only minority shares and the companies already met the requirements for joint stock corporations, and were managed as private companies. In the case of Bolu Çimento, stock was already traded on the ISE. Afyon Çimento was also relatively easy since all of the financial work had been completed and the sale to SCF had established a market value.

It is worth mentioning that the Nigde Çimento privatisation stands out during the period of 1990-91. Nigde Çimento was the only company where the PPA's share of ownership approached 100 per cent and where an attempt was made to privatise the company through the capital market. But this proved to be a great mistake made by the PPA despite the advice given by its financial advisors. The PPA not only offered the shares of Nigde Çimento to the public in a declining stock market but also it set a very high offering price. The result was quite disastrous. Only about 7 per cent of the offering was taken up by investors (Kikeri *et al.*, 1994, p.264).

Figure 6.1: Geographical Location of Cement Plants in Turkey

Note: Names in bracets show the owner of the cement plants.
Source: Privatisation Administration and various data collected during the fieldwork.

Table 6.1: Privatised Cement Plants by Public Offering

Privatised Cement Firms	*PA Share (%) as of Offering Date*	*% of Shares Sold*	*Sales dates*	*Sales Value ($)*	*No. of Bids*
Bolu Çimento	34.50	10.38	April 1990	8,268,150	8,157
Konya Çimento	39.87	31.13	October 1990	17,663,979	6,396
Ünye Çimento	49.21	2.86	November 1990	927,162	281
Mardin Çimento	46.23	25.46	November 1990	9,161,501	1,280
Adana Çimento	47.28	34.32	February 1991	27,958,470	3,355
TOTAL				***63,979,262***	***19,469***

Source: PA (1995b); PA (1996); PA (1994); *Dünya*, 22.06.1994 and various documents gathered during the fieldwork.

Table 6.2: Privatised Cement Plants by Public Offering and Block Sales

Privatised Cement Firms	*PA Share (%) as of Offering Date*	*% of Shares Sold*	*Buyer*	*Sales Dates*	*Sales Value ($)*	*No. of Bids*
Afyon Çimento						
- Block sale	99.60[1]	51.00	SCF[2]	Sept. 1989	13,000,000	--
- Public offering	48.60	39.87	public offer	March 1991	8,422,698	12,591
Nigde Çimento						
-Public offering	99.84[1]	12.72	public offer	May 1991	2,647,286	1,125
-Block sale	87.12	87.10	OYAK-Sabanci	March 1992	22,500,000	--
TOTAL					*46,569,984*	*13,716*

Note: (1) The remaining shares held by PA have been totally sold via ISE at various dates; (2) SCF: Société Ciment Français.
Source: See Table 6.1

Table 6.3: Privatised Cement Plants by Block Sales

Privatised Cement Firms	*PA Share (%) as of Offering Date*	*% of Shares Sold*	*Buyer*	*Sales Dates*	*Sales Value ($)*
Block Sales in 1989					
Ankara Çimento	99.30	99.30	SCF[1]	8.9.1989	33,000,000
Balikesir Çimento	98.30	98.30	SCF	8.9.1989	23,000,000
Söke Çimento	99.60	99.60	SCF	8.9.1989	11,000,000
Trakya Çimento[2]	99.90	99.90	SCF	8.9.1989	25,000,000
Block Sales 1992-96					
Iskenderun Çimento	100.00	100.00	OYAK-Sabanci	2.12.1992	61,500,000
Gaziantep Çimento	99.73	99.73	Rumeli Çimento	3.12.1992	52,696,898
Trabzon Çimento	100.00	100.00	Rumeli Çimento	3.12.1992	32,551,000
Denizli Çimento	100.00	100.00	Modern Çimento	4.12.1992	70,100,000
Çorum Çimento	100.00	100.00	Yibitas Holding	25.121992	35,000,000
Sivas Çimento	100.00	100.00	Yibitas Holding	25.12.1992	29,400,000
Ladik Çimento	100.00	100.00	Rumeli Çimento	21.4.1993	57,598,687
Sanliurfa Çimento	100.00	100.00	Rumeli Çimento	21.4.1993	57,405,988
Bartin Çimento	99.78	99.78	Rumeli Çimento	6.51993	20,568,669
Askale Çimento	100.00	100.00	Erçimsan	17.6.1993	31,158,000
Adiyaman Çimento	100.00	100.00	Teksko A.S.	16.8.1995	52,500,000
Elazig Çimento	100.00	99.89	OYAK/Gama	12.6.1996	27,850,000
Van Çimento	100.00	100.00	Rumeli Çimento	12.6.1996	24,500,000
Lalapasa Çimento	100.00	100.00	Rumeli Çimento	14.6.1996	125,890,000
Kars Çimento	100.00	100.00	Çimentas	18.6.1996	22,250,000
TOTAL					***792,969,242***

Note: (1) SCF: Société Ciment Français; (2) also known as Pinarhisar Çimento.
Source: See Table 6.1; *PMENA*, 29 July 1996.

Following the above experience with Nigde Çimento, the PPA turned to the domestic investors to privatise Çitosan's cement plants. As shown in Table 6.2 and 6.3, the PPA completed seven block sales of cement companies in 1992. The first was the March 1992 sale of the remaining 87.1 per cent stake in Nigde Çimento to OYAK-Sabanci. In May 1992, the PPA advertised 11 cement companies for sale through negotiated bids. The negotiated bids received for Adiyaman, Askale, Bartin, Ladik, and Sanliurfa were rejected by the Privatisation High Council as insufficient while six of the bids were approved on 16 November 1992. In early 1993 the PPA reached an agreement to sell Ladik, Sanliurfa, and Bartin for a total of $135.5 million. Later in 1993, Askale was sold to Erçimsan for $31.1 million. The only cement company sold in 1995 was Adiyaman Çimento to Teksko Giyim for $52.5 million. The latest privatisations in the cement industry are the sales of Elazig, Van, Lalapasa and Kars Çimento to domestic investors for a total of $200.6 million in 1996. With this latest purchase, Rumeli Holding increased its number of cement plants bought through privatisation to seven, and it appeared to be the largest investor in the cement privatisation.

One of the characteristics of the privatisation in the cement sector is the tendency for neighbouring cement plants to buy privatised plants as they become available. The sales completed up to date and information about unsuccessful bidders indicate that private cement companies have preferred to bid on companies close to their existing operations.[4] Figure 6.1 shows the cement plants and their owners in Turkey. Some experts and managers in the cement industry I interviewed during the fieldwork justify this move on the grounds of managerial efficiency and they argue

[4] For example, SET Group made a bid for Bartin and Denizli cement while OYAK-Sabanci's bidding was for Nigde and Iskenderun cement plants. Rumeli Holding who had previously bought Trabzon and Gaziantep, also made a bid for Ladik, Sanliurfa and Bartin cement plants (see Figure 6.1 for the locations of the plants).

that further economies of scale will lead to greater productive efficiency thereby to lower consumer prices. In contrast to this, the critics of the cement privatisation argue that the increased size of regions dominated by a single or two companies will lead to higher consumer prices, greatest profits and probably a loss of efficiency in the sector. They furthermore maintain the view that the primary rationale for purchasing neighbouring cement plants is to increase dominance in regional markets by increasing the distance to the nearest competitor. In fact, this is very close to the advice given by the Sema-Metra (1986) which did not recommend the government to allow neighbouring plants to purchase each other because of the possibility of creating uncompetitive conditions in regional markets.

Probably, as a result of the concerns raised above, the Ministry of Industry indirectly tried to intervene in the sale of Adiyaman Çimento in 1995. The Ministry suggested that the plant should not be sold to one of the existing cement holding groups on the grounds of the creation of a local monopoly. The Ministry wrote to the PA that if the plant was sold to Sabanci, Rumeli or its present owner Teksko, these cement holdings would increase their share in the region to 40 per cent, and this was against the Competition Law which they are trying to get established (*Cumhuriyet*, 21.7.1995; *Dünya*, 9.12.1995). This argument was refuted by the managers in the cement sector and PA officials. One said that "in a market where more than 18 cement companies exist, it is not possible to argue that the Turkish cement sector has a monopolistic structure".[5] The Ministry's statement was also regarded as 'manipulative' in order to sell Adiyaman Çimento to one with a lower price. Indeed,

[5] Some of the major cement producers and their shares in total cement production of 30 million tons in 1994 are as follows: Sabanci Group (12%), OYAK (13%), OY-SA (4%), Set Group (7%), Rumeli (7%), Çitosan and PA (10%).

as a result of this, PA officials believes that they received a smaller number of bids for this plant (personal interviews, September 1995).

In 1993 there were 46 cement factories operating in Turkey with a total production of 32.4 million tons of cement which represented 2.6 per cent of the world cement production (PA, 1994). The report by the SPO (1993, p.81) estimates that the total cement production capacity will increase to about 45 million tons by the turn on the century. Between 1993 and 1999, an average additional cement capacity increase of 2-5 million tons per annum is expected. Nonetheless, as a result of the privatisation carried out in the sector, the state's cement holdings have been reduced to two firms in 1996, which had already been transferred to the PA and should be privatised soon. The share of the state sector in the total cement production was reduced to approximately 3 per cent in 1996 (PA, 1996). Hence, as Mr. Satiroglu, Vice President of SET Group[6] puts it "the private sector became a 'leader' instead of its assumed role of a 'follower' after several decades" in the Turkish cement industry (Satiroglu, 1995, p.2).

6.4 Privatisation of Five Cement Companies

The sale of Çitosan's five cement plants was the third big privatisation initiative after Teletas and the USAS experiment. In September 1989, the Privatisation Administration sold its entire share, ranging from 99.3 to 99.9 per cent of four cement companies (Ankara, Balikesir, Söke, and Trakya)[7] and 51 per cent of a fifth cement plant (Afyon) to a French company, SCF, for $105 million.

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[6] SET Group Holding is a subsidiary of SCF which was established to manage its cement companies in Turkey.

[7] SCF sold all its shares in Söke Çimento to Batiçim in 1993 and bought Anadolu Çimento (also known as Kartal) located in Istanbul.

Comparative profitability figures for these plants are shown in Table 6.8. The average profitability rate (1986-88) for five cement plants is 20 per cent which is slightly over the average profitability rate for the private sector cement firms in Turkey. But it is significantly higher than the 11.5 per cent average profit rate of public sector cement plants. However, the Sema-Metra Report (1986) shows that the average capacity utilisation of these five plants was substantially higher than the average for all public sector cement plants (75% versus 58%) and approached the private sector's capacity utilisation rate of 79 per cent for the earlier period.

Prior to privatisation, in 1988, our calculation based on SPO (1993, p.16-22) figures indicates that there is a slight increase on all of the figures above. The clinker capacity utilisation of five cement plants, for instance, went up to 85 per cent against 78 per cent for Çitosan's all Eastern plants, while private sector cement plants kept their high performance of capacity utilisation at around 86 per cent. In the post-privatisation period, however, it is evident that the capacity utilisation rate further improved in all cement plants belonging to three types of ownership. The clinker capacity utilisation of five privatised plants, for instance, was over 87 per cent while the rate of improvements for the private sector plants was much higher (95%) in 1992. The capacity utilisation rate for public cement plants (77%) remained at around the level of 1988.[8]

Figure 6.1 shows that the five cement plants are geographically concentrated in the western regions and close to the big cities (Istanbul, Ankara and Izmir) where demand is strong. The newest of these plants, Söke, began operating in 1962. Other characteristic of these five cement plants is that they were built during the period when

[8] The average low capacity utilisation rate for the five privatised cement plants is attributed to the modernisation work in Trakya Çimento which worked only with its half capacity at the time (Satiroglu, 1995).

decisions were based primarily on return on investment, but all required substantial improvements and modernisation. Two of the plants had less efficient, semi-dry production process and all five required additional pollution controls. One requirement of the sale was at least $100 million new investment by SCF for modernisation and improvements over a five year period. This requirement appears to have been met through the reinvestment of retained earnings (Satiroglu, 1995). These five plants were judged to be among Çitosan's most desirable plants by Sema-Metra Report and were among Çitosan's most profitable companies.

The court challenge to this sale and subsequent politicisation of the privatisation programme was discussed in the previous chapter. The sale also required that up to 40 per cent of the company be offered to Turkish investors within a five year period. The requirement to sell shares to the public appears to have been a political concession to dampen criticism that Turkish companies had been sold to foreign investors. Since only a minority stake must be sold, SCF would retain control, and there are no provisions for enforcing sale of stock under adverse conditions, nor any mechanism for setting a price on the stock. This requirement does not impose a burden on the company, and in fact the company expressed interest in offering shares to the public as soon as the market conditions were favourable. Mr. Satiroglu indicated that "we [SET Group] are planning share sales in the stock exchange when the time is right" (personal interview, September 1995). Following the public offering of the mixed sector cement companies in 1990-91, the PPA sold its remaining shares in Afyon Çimento through public offering in March 1991 (see Table 6.2).

6.5 Performance Evaluation of Privatised Enterprises

The performance of privatised cement plants is examined in two steps: financial profitability of the firms based on ROS, ROA, ROE and productivity indicators which show gains in economic efficiency such as SALEFF, GVA and OUTEMP per employee.

6.5.1 Financial Performance: Profitability

Comparable data for the five privatised cement companies for the period of 1986-1995 is presented in Table 6.4. The table consists of three different measures of financial efficiency for these firms starting from 1986. Except Ankara Çimento in 1988, five privatised cement plants had registered good performance between 1986 and 1988. Table 6.4 shows that all the plants showed near or above a 20 per cent rate of profitability. When these figure are compared with the average figures of 1986-88 period for the private and public sector, Table 6.8 indicates that the average profitability for five plants is slightly above the private sector for the same period, and it is almost double compared to the rest of the public sector.

The other measures for financial performance (i.e. ROA and ROE) are far from being conclusive. There are sharp rises and falls in these two financial measure employed from one year to another and from one company to another. Thus it is very difficult to make a consistent statement. However, having said that, in terms of the rate of return on net assets (ROA), most of the privatised cement plants, with the exception of Ankara Çimento, present an impressive profitability of over 50 per cent in the pre-privatisation period. As can be seen in Table 6.4 and 6.8, the average figures for the five privatised cement plants in terms of the rate of ROA are significantly higher than both the private and public sector plants for the period of 1986-88. It is argued that due to these high figures of profitability and the rate of

ROA as mentioned above, privatisation of these cement companies proved to be a easy task and attracted bids from a large number of domestic and international investors including the present owner SCF (Karluk, 1994; Kök, 1995).

In the post-privatisation period, it is not possible to draw a common conclusion due to the inconsistent trends in financial performance indicators. For Afyon Çimento, the rate of return on sales revenue (ROS) remained around 16 per cent and declined to 4.4 per cent in 1991 and became negative value of 0.6 in 1992. In the first three years (i.e. 1989-91) of the post-privatisation period, Ankara and Balikesir Çimento registered a negative declining profitability which became small positive figures in 1991. The profitability trend for Trakya Çimento is identical with Ankara and Balikesir. Trakya's profitability rate started to decline from 14.7 per cent in 1989 to 3 per cent in 1991. Among those cement plants only Söke Çimento had a steady increase from 1989 to 1991.

In the second phase (i.e. 1992-95) of post-privatisation era, Afyon, Balikesir and Söke Çimento were able to increase their profitability from negative values to modest positive figures in 1993 and they even had better profitability performance in 1994. Yet, the profitability rate for Ankara Çimento continued to decline until 1995 except a modest increase in 1992-93, while the rate of ROS for Trakya Çimento registered a steady improvement between 1992 and 1994 from -11.5 to -0.1 per cent and then declined again in 1995.

Table 6.4: Changes in Performance Indicators of Five Privatised Cement Plants, 1986-1995

Company	Performance Measure	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Afyon Çimento	ROS (%)	19.9	20.5	16.7	15.4	16.1	4.4	-0.6	6.2	6.3	0.3
	ROE (%)	268.4	315.1	201.5	201.7	256.6	62.7	-7.0	59.9	46.0	2.4
	ROA (%)	54.5	45.6	53.5	47.0	49.3	11.6	-2.1	14.6	10.4	0.7
	SALEFF (000TL)	61	108	65	73	93	108	113	161	112	93
	GVA (000TL)	23	39	23	22	40	40	45	40	60	N/A
Ankara Çimento	ROS (%)	6.9	13.2	0.6	-15.8	-3.2	1.6	3.5	2.8	-46.5	-45.2
	ROE (%)	164.3	157.1	5.3	-116.2	-26.5	10.4	5.1	4.4	-48.1	-31.1
	ROA (%)	15.9	21.7	1.1	-30.4	-8.5	3.6	2.6	1.4	-14.4	-12.9
	SALEFF (000TL)	93	126	116	85	128	115	158	198	186	181
	GVA (000TL)	27	42	12	16	37	36	38	112	33	N/A
Balikesir Çimento	ROS (%)	35.2	28.1	7.9	-12.6	-1.5	5.2	-4.4	0.9	23.0	4.9
	ROE (%)	139.8	121.4	119.0	-82.6	-7.7	36.3	-23.1	3.9	77.2	27.9
	ROA (%)	53.5	47.6	47.8	-17.6	-4.1	9.5	-7.0	1.6	27.4	5.7
	SALEFF (000TL)	65	66	55	59	100	94	121	125	103	104
	GVA (000TL)	31	36	24	17	29	36	35	31	37	N/A
Söke Çimento	ROS (%)	21.6	14.1	18.7	8.6	14.1	15.1	-1.0	1.0	17.2.	19.9
	ROE (%)	162.1	260.2	229.5	n.a.	134.8	n.a.	-5.2	4.7	37.3	41.7
	ROA (%)	52.0	50.2	56.7	n.a.	24.9	n.a.	-1.3	1.9	22.4	29.6
	SALEFF (000TL)	48	90	65	49	66	n.a.	88	149	173	197
	GVA (000TL)	15	26	20	n.a.	25	n.a.	32	49	70	N/A
Trakya Çimento	ROS (%)	25.4	27.5	23.2	14.7	6.7	3.0	-11.5	-22.1	-0.1	-12.0
	ROE (%)	172.6	186.8	182.0	91.5	38.8	21.7	-48.9	-148.1	-0.1	-14.6
	ROA (%)	56.4	55.3	56.0	22.5	10.7	3.7	-10.7	-21.9	-0.0	-7.8
	SALEFF (000TL)	112	100	107	100	170	110	154	179	170	143
	GVA (000TL)	45	34	29	25	37	31	43	53	143	N/A

Note: All figures are converted to 1981 constant prices by deflating them with Wholesale Price Index (1981=100); n.a.= not available.
Source: The table was tabulated from the data provided by the ICI, *Turkey's 500 Large Industrial Establishments*, various issues; SIS (1996); ISE, *Yearbook of Companies*, various years; SPO (1993); Suiçmez and Yildirim (1993); PA (1994); Annual Reports of the cement companies.

Table 6.5: Output per employee (OUTEMP) in Five Privatised Cement Plants (Ton), 1986-1995

Company	Perf. Measure	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Afyon Çimento	Ton/Men	1038	1542	1108	1287	1330	1579	1512	2535	2395	2295
Ankara Çimento	Ton/Men	1556	1861	1801	1586	1913	2082	2564	3226	3080	3314
Balikesir Çimento	Ton/Men	1050	1082	962	1128	1067	1508	1954	2132	2086	2429
Söke Çimento	Ton/Men	823	836	890	902	878	1145	1403	2479	3855	4763
Trakya Çimento	Ton/Men	856	825	1205	1243	2173	1516	2095	2462	2956	3285

Note: See Table 6.4.
Source: See Table 6.4.

Table 6.6: Average Output per employee in Five Privatised Cement Plants, 1986-1995

Company	Pre-Privatisation		Post-Privatisation				Labour Productivity		
	1986-88		1989-91		1992-95		1986-88	1989-91	1992-94
	Cement Prod.	No. of Men	Cement Prod.	No. of Men	Cement Prod.	No. of Men	Ton/Men	Ton/Men	Ton/Men
Afyon Çimento	425,796	353	416,348	302	421,660	198	1206	1379	2230
Ankara Çimento	707,430	408	586,037	318	627,844	208	1734	1843	3018
Balikesir Çimento	407,150	395	416,733	346	396,908	185	1031	1204	2145
Söke Çimento	245,347	289	235,220	244	375,834	130	849	964	2891
Trakya Çimento	352,567	367	462,333	296	542,454	192	961	1562	2825
Average	***427,658***	***362***	***423,334***	***301***	***472,940***	***183***	***1181***	***1406***	***2584***

Note & Source: See Table 6.4.

Table 6.7: Comparison of Performance Indicators for Private, Public Sector and Five Privatised Cement Firms, 1986-1994

Sector	Performance Measure	1986	1987	1988	1989	1990	1991	1992	1993	1994
Private	*Profitability Indicators*									
Sector	ROS (%)	20.7	20.4	16.5	10.9	16.2	17.4	15.7	18.0	16.4
Cement	ROE (%)	85.3	129.3	78.3	37.6	59.1	54.1	50.3	57.7	44.7
Firms	ROA (%)	30.7	29.1	21.9	15.3	23.0	22.8	20.2	21.1	16.0
	Productivity Indicators									
	SALEFF (000TL)	101	111	110	90	121	145	160	189	163
	GVA (000TL)	41	48	48	34	52	61	63	74	57
Public	*Profitability Indicators*									
Sector	ROS (%)	18.2	12.7	3.6	6.8	5.7	3.4	3.5	7.4	20.2
Cement	ROE (%)	77.9	62.3	18.9	18.5	18.9	8.6	12.4	24.3	44.2
Firms	ROA (%)	29.4	19.9	5.3	8.4	7.0	4.0	4.8	9.8	20.7
	Productivity Indicators									
	SALEFF (000TL)	68	79	81	96	79	87	77	66	54
	GVA (000TL)	26	25	21	29	30	30	33	32	26
Five	*Profitability Indicators*									
Privatised	ROS (%)	21.8	20.7	17.4	2.1	6.4	5.9	-2.8	-2.2	0.0
Cement	ROE (%)	181.4	208.1	147.5	23.6	79.2	56.2	-15.8	-15.0	22.5
Firms	ROA (%)	46.5	44.1	43.0	5.4	14.5	7.1	-3.7	-0.5	9.2
	Productivity Indicators									
	SALEFF (000TL)	76	98	82	73	111	107	127	162	149
	GVA (000TL)	28	35	22	20	34	36	39	57	69

Note: The calculations for 1990-1994 are done by the researcher based on the ICI data, whilst some of the figures for the period of 1986-1989 are based on the study of Suiçmez and Yildirim (1993). Thus, there may be some distortions in figures for 1986-89 period.
Source: See Table 6.4.

The management of the five cement company, SET Group, related this relatively poor performance to its new investments. The management stated that after the privatisation in the cement industry, a tremendous investment movement started. In the five plants, annual investment spending has grown 8-10 times when compared with the similar period before privatisation. Consequently, the management of SET argues that the cost of new investment such as high depreciation and credits and interests costs is the main reason for low profitability rates in the five privatised cement plants (personal interview, September 1995).

The data provided by the company shows that the SCF has invested around $300 million since 1989 which is three times more than the amount cited in the sales agreement. Most of this money was spent on modernisation and environmental protection projects at the plants besides SET Group's major expansion into ready-mixed concrete, pre-fabricated products and aggregates. The SET Group expected to increase its profitability and cut its production costs by restructuring and modernising production methods at its plants. As a result of the investments made, the total production capacity of the five plants also increased about 35 per cent in 1995 as compared to 1989 (Satiroglu, 1995). Therefore, since SET Group has already completed its major investment programme, the management predicts that the rate of profitability for the privatised cement plants should start improving slowly but steadily in the second half of the 1990s.

The above trend in investment, in fact, can be observed throughout the sector. The cement companies invested more than TL4,074 billion (in constant 1992 prices) between 1986 and 1992 on modernisation, automation, capacity increase and the development of new products. Investments made in two areas are important to discuss

here; ready mixed cement (RMC)[9] and pollution preventive systems (SPO, 1993, p.93-98).

The production of RMC and prefabricated concrete was very insignificant until 1988 compared to the total cement production. In 1989, the total RMC production was only 1.5 million cubic metres. This has grown about ten times over the years and reached 11 million cubic metres in 1993 which still represents only 10 per cent of total cement production in the country. Some cement producers in Turkey came to the conclusion that the arrival of foreign cement firms (i.e. SCF, Lafarge Coppee- the world's largest cement producer and Société Ciment Vicat) with the privatisation which has started in the sector in 1989, quickened the production and spread of the new products including RMC and prefabricated concrete (*Dünya*[10], 6.6.1994). Furthermore, there are some positive developments in terms of quality improvements of these products too. Since 1994, RMC and prefabricated cement products must be approved by the Turkish Standards Institute. The expansion and efforts to improve the quality of cement products have been continuing with the new investments in the sector and it is expected that by the year 2000 the Turkish cement industry would able to reach the capacity of 50 million cubic metres RCM and prefabricated concrete.

Since the pollution of the environment has become an important issue globally, the Turkish cement industry has also made significant investments on pollution preventive systems. Apart from the condition attached to the sale agreement between the PA and SCF which required the latter to invest $100 million in the five plants within the next five years but did not specify in which areas this money should be spent, this study has found no evidence which requires the privatised cement

[9] It is also called ready mixed cement.

[10] Special supplement of *Dünya* daily newspaper on cement and ready mixed cement. The view expressed about foreign cement firms was quoted from the newspaper on p.13

companies to invest in environmental safeguards. However, it is understood that most of the cement firms including the privatised ones have been investing in pollution preventive systems and replacing the old technology with modern electrofilters systems while they are implementing their major modernisation programmes at the plants. This can be the result of two main factors; partly the willingness of the cement producers to stop the air pollution their plants create and partly due to the demands and pressures put on the cement producers by the local pressure groups rather than any specific government legislation regarding the matter. As a result, the cement sector in Turkey invested in environmental safeguards 800 billion TL (in constant 1992 prices) between 1986-92 and it is expected to invest another 675 billion TL until the year 2000 (SPO, 1993, p.39 & p.93-98; ISE, 1995, p.33).

Figures in Table 6.4 also show that not only ROS ratios but ROA ratios were also significantly negative for many firms in several years in the period of 1989-93. But it is still possible to note that Afyon Çimento's net asset profitability was exceptionally high for two years after its privatisation and recorded around 47 and 49 per cent net asset profitability in 1989 and 1990, and declined to 11.6 per cent in 1991 which increased to 14.6 per cent in 1993 after being -2.1 per cent in 1992. The other three plants (Ankara, Balikesir and Trakya) had rather weak, and in some years negative ROA ratios. However, it is not possible to make a comment on the profitability of the fifth plant, Söke, due to lack of consistent statistical data.

The data in Tables 6.7 and 6.8 is classified by the type of ownership to allow comparison of the performance of private, public and five privatised cement plants. Comparison between these three groups of cement plants presents a completely different picture. The average profitability figures for the five cement plants are well below both the private and public ones in the post-privatisation period. As Table 6.8

illustrates, the average ROS ratio for the private sector cement plants is about 15 and 18 per cent in the periods of 1989-91 and 1992-94 respectively. Even though, it looks as if the remaining public sector plants out-performed the privatised cement plants (from 5.30% in 1989-91 period to 15.5% in 1992-94 period), experts on the cement sector give a cautious welcome to the figures. They argue that this outstanding improvement in the profitability of the public sector plants may be the result of the cash injection to restructure Çitosan's remaining plants before their privatisation. In particular, they point out the rate of profitability of the public sector cement plants. The profitability rate of Çitosan's plants (15.5%) is slightly below the private sector (18.3%). Hence, it is believed that this unusual and notable improvement in the performance of the public plants can be related to the government's efforts to restructure the balance sheets of the firms before putting them in the sale list (personal interview, September 1995).

Figures in Table 6.8 also show that the five privatised cement plants recorded in the first post-privatisation period 4.8 per cent of profitability which became a negative value of 1.7 per cent in 1992-94 period. The financial performance of the five privatised cement plants is well behind the private sector cement plants in the post-privatisation period. During this period the average performance of the remaining public sector cement plants recorded a higher rate of ROS and ROA than five privatised plants. Those plants privatised in 1989 had very low rate of ROS figures for 1990 and 1991. Further, except for Ankara and Balikesir cement plants, the rate of ROS has tended to fall or remain steady over the observation period for the five privatised companies. The rate of ROS became negative in 1989-90 for Ankara and Balikesir cement plants.

Table 6.8: Comparison of Average Performance Indicators of Private, Public Sector and Five Privatised Cement Firms, 1986-1994

Company	Performance Measure	Pre-Privatisation 1986-88	Post-Privatisation 1989-91	1992-94(*)
Private Sector Cement Firms	*Profitability Indicators*			
	ROS (%)	19.2	14.8	18.3
	ROE (%)	97.6	50.3	50.9
	ROA (%)	27.2	20.3	19.1
	Productivity Indicators			
	SALEFF (000TL)	107	119	171
	GVA (000TL)	46	49	65
Public Sector Cement Firms	*Profitability Indicators*			
	ROS (%)	11.5	5.3	15.5
	ROE (%)	53.0	15.3	40.5
	ROA (%)	18.2	6.5	17.6
	Productivity Indicators			
	SALEFF (000TL)	76	87	66
	GVA (000TL)	24	29	45
Five Privatised Cement Firms	*Profitability Indicators*			
	ROS (%)	20.0	4.8	-1.7
	ROE (%)	179.0	59.4	-2.8
	ROA (%)	44.5	11.5	1.6
	Productivity Indicators			
	SALEFF (000TL)	85	94	146
	GVA (000TL)	28	29	55

Note: (*) Due to the lack of data for 1995, the average performance figures of 1992-95 for the private and public sector firms could not be calculated. Therefore, the average figures of 1992-94 period is used for all three groups.
Source: See Table 6.4.

Government policy regarding privatisation is primarily aimed at increasing the operating efficiency of former state enterprises. The assumption here is that the switch in ownership from state to private should have a predictable impact on a firm's financial policies. From this point of view, one presupposes that if the rate of ROS and others such as the rates of ROA and ROE had risen over the period, this would be interpreted as evidence that the performance of the privatised companies improved as a result of privatisation. The failure of these firms to produce a higher rate of return is somewhat puzzling, and perhaps indicates that a change in management requires a period of time to produce better results. Alternatively, as the Chairman of SET Group,

Mr. Ignebekçili, explained the court case was "the most difficult challenge had to be faced by the company following the privatisation" and it clouded the purchase of these firms by creating a period of uncertainty as well as by delaying and complicating managerial changes which were needed at that time to start new investments to upgrade the existing old technology (*Dünya*, 22.6.1994). Note that the net margin of the private and public sectors is substantially higher than for the five privatised cement companies especially in 1992-94 period. It is also possible to relate this to a number of factors. Firstly, the decline in net margin may reflect alternative accounting procedures, or secondly, this can be also attributed the cost of new investments as explained earlier. Thirdly, as already mentioned, a troubled transition period (due to the court case) may have also contributed to the relatively poor performance of these companies under private ownership.

6.5.2 Productivity Performance

In order to assess the internal efficiency of the privatised enterprises, it is necessary to base the analysis on one or more of a variety of productivity indices. Some of the principal approaches often adopted to analyse labour productivity are productivity indicators based on output, value added per head or total factor productivity (TFP). It was not possible for this study to collect all the variables needed to calculate TFP for the firms examined here, but the ratios of gross value added per employee (GVA) and sales per employee (SALEFF) in real terms, and output per employee (OUTEMP) which measures output as a ratio of a single factor input (i.e. number of employees), are selected as the productivity indicators to test the efficiency of the cement firms. Numerous data for productivity indicators per employee in cement industry was gathered from the different sources previously mentioned.

Regrettably not all data was available for all firms for each year, and in those cases where multiple sources are available, the figures may not agree. Among the problems with this data is the tendency to underreport employment in the later years as well as the lack of data for sub-contracting figures. Another problem is the dramatic wage increase won by the unions in 1990 and later in 1991. For example, in real terms, the wages of unionised workforce in manufacturing sector increased 129 in 1990 and then 190 in 1992 compared to 85 in 1988 (TÜSIAD, 1994, p.41). This led later on to subsequent reduction in employment, especially by the private sector cement firms.

The cement industry shed roughly one quarter of its labour force from the end of 1990 through the end of 1994. The SPO (1993, p.103) report provides information about the reduction in employment in the cement industry. The size of the workforce was reduced to 12,750 in 1993 from 17,173 in 1990. This reduction is even sharper in the five privatised cement plants. SCF management cut the size of its labour force by almost half from 1,711 employees in 1989 to 863 in 1994. Mr. Satiroglu notes that:

> ... besides the automation programme implemented, the labour cost soared in the early 1990s, hence we [SET Group] tried to reduce the excess labour to a reasonable level usually through early retirement and voluntary redundancies, and at the same time we organised an intensive training programme to increase the productivity of our employees (personal interview, September 1995).

It is, however, difficult to prove that all of the reductions are real since some positions were reclassified as white collar, thus removing them from the union, and other positions were reduced due to contracting out with outside non-union firms. Unfortunately, data on the extent of subcontracting is not available yet. SET Group could not produce a figure and they admitted that they had no idea how many subcontract employees they had. Çimse-Is, the employee trade union in the cement

industry, was very concerned about subcontracting and stated that they have not objected too strongly to privatisation, but instead have concentrated their efforts on slowing down subcontracting since this has a more immediate effect on the number of union members. SET Group replied to this by stating that only less than 50 union positions lost out of 863 employees by the end of 1994 resulted from reclassification. Nevertheless, both reclassification and outside contracting would still tend to inflate job losses from the union's perspective (personal interview, January 1996).

Changes in employment may also reflect a shift toward more capital intensive, technologically-advanced production methods in response to 'excessive' wage demands. Again some of the company executives during the interviews expressed the view that in order to be competitive with other firms, especially with those in international market, either they have to keep the wages down as a cost factor or they needed to lead their companies into more automated systems which would be more capital intensive. Perhaps as a consequence of this, at least some of the companies responded to wage increases by slashing employment as a disciplinary measure and increasing pressure on the government to rein in the unions. The private firms and especially the privatised firms appear to have shed labour more rapidly than the public firms.

A review of figures presented in Table 6.4 for the five privatised cement plants indicates that there has been significant improvements in labour productivity in the post-privatisation period (1989-95) compared to the pre-privatisation period. Indeed, the figures indicate that gross value added per employee (GVA) at constant prices doubled. What is interesting here is that GVA per employee in real terms tended to increase, except for Trakya Çimento, in the first two years (i.e. 1986-87) and then all plants registered a steady decline in GVA per employee in 1988-89 period. This

decline was even sharper in Ankara Çimento from TL42,000 to TL12,000 in 1988. Comparison with the private and public sector cement plants for the GVA per employee shows that the five privatised cement plants performed better than the public sector plants but still their average performance figure was significantly below the average of private sector cement plants in the pre-privatisation period of 1986-88 (see Table 6.8).

This declining trend in terms of GVA per employee for the five privatised plants was reversed after the privatisation in 1989. As Table 6.4 shows almost all five plants were able to record large productivity increases in the post-privatisation era. The average figures are thought to be more appropriate for making comparisons between the firms and years, because these average figures for three periods will eliminate any inflated or deflated effect in a single year on the performance of the companies. The average GVA per employee for the five privatised cement firms increased from TL28,000 in 1986-88 period to TL55,000 in the post-privatisation years of 1992-94. Though the average productivity of the five plants looks higher than the public sector plants, it is still well below the rate of private sector cement plants (see Table 6.8).

The second measure employed for labour productivity which is sales per employee (SALEFF), is also identical to the GVA figures and SALEFF per employee recorded a very significant improvement during the observation period. The figures in Tables 6.4, 6.7 and 6.8 show that the average sales per employee in the five privatised cement firms in real terms grew considerably in the post-privatisation period, and reached TL146,000 in the 1992-94 period compared to TL85,000 before the privatisation. This figure is again twice the figure for the public sector plants but below the private sector SALEFF level.

The evidence presented above suggests that privatisation has had a significant effect on the labour productivity (at constant prices) of these five privatised cement companies. This significant improvement in labour productivity may also be largely related to the reduction in the number of employees resulting from a more realistic employment policy pursued under the new management which was discussed earlier.

The third productivity measure used for the performance analysis of the privatised enterprises is output per employee (OUTEMP). The OUTEMP is employed as a labour productivity indicator in order to arrive at some conclusions regarding the relative efficiency of privatised cement plants, and then compare the results with the public and the private sector cement firms in Turkey. The productivity figures indicate that the public plants are significantly less efficient than the five privatised and private sector cement plants. Hence it agrees with Karatas's (1993) finding that labour productivity at the private and privatised plants exceeded that of public sector plants.

Output per private sector worker is about twice that of public sector workers. In 1992, for example, while a cement worker in private sector produces about 2,304 tons of cement, output for public sector worker is only 1,030 tons per year. The efficiency difference between the two is even greater in 1994; private and public cement workers' output is 3,627 and 1,159 tons of cement per year respectively, which shows much faster productivity increase in the private sector than the public one. The output per worker for the five privatised cement plants is 1,906 tons in 1992 compared to 1,030 tons for Çitosan's plants.[11]

Some of the difference in productivity between the private and public sector cement plants can be attributed to scale economies. Prior to privatisation, the

[11] These productivity figures were calculated by the researcher from the following sources: SPO (1993), Dünya (6.6.1994), PA (1994).

publicly-owned plants in Turkey tended to be smaller with an average cement production capacity of 425,000 ton compared to 745,000 tons per year for the private cement plants. The largest of the Çitosan plants were about the same size as the smallest private plants. Only five Çitosan plants were larger than the smallest private plants.[12] Most of the Çitosan plants have capacities of 200,000 to 400,000 tons, while most private plants have capacities of 1,000,000 to 2,000,000 tons per year. The two largest cement plants in Turkey are privately owned Çanakkale Çimento and Akçimento with an annual capacity of 2.3 and 2.2 million tons (SPO, 1993, p.20-21). Cement ownership and size seem to be highly correlated with geographic location too. Large and privately-owned plants appear to be located in the Marmara, Aegean and Mediterranean regions, while those in the interior, and Black Sea regions are small state-owned plants (SPO, 1993, p.37-38). Since cement production has significant scale economies, it is expected that the large plants will have a higher output per worker than the smaller plants.[13]

However, scale of production accounts for some, but certainly not all of the difference in inefficiency between the public and private cement plants. One should also look at the age of the plant, conversion from wet to dry production processes, and degree of automation. SPO (1993) figures show that old, small, and in particular wet process plants, have a large number of workers relative to productions capacity.

The productivity figures in Table 6.5 and 6.6 indicate superior performance by the five privatised cement plants. All five plants doubled their production per employee in 1995 compared to 1989 figures. Although these results are open to discussion since little is known about the rate of subcontracting, Table 6.6 shows

[12] These are Denizli, Ladik, Adiyaman, Ergani and Gaziantep Çimento with capacities ranging from 545,000 to 640,000 tons per year.

[13] Cement production is described as a continuous process with large economies of scale at the level of the plant, but little increase in productive efficiency from horizontal or vertical integration.

notable changes in the average output per employee in the five privatised cement plants after privatisation. Because figures for a single year can be inflated by the loss of a production line, or deflated by the addition of new cement capacity, it is thought that the average figures are more appropriate for making comparisons between firms and years than the yearly figures.

The average output per worker in the five cement plants has increased to 2,584 tons in 1992-95 period from 1,181 tons in the pre-privatisation period of 1986-88 (see Table 6.6). The average output per worker in the five privatised plants for the 1989-91 period is 1,406 tons which is significantly below the average output per worker of 2,600 tons for the Turkish private cement industry in 1990 (SPO, 1993, p.70). Thus, the five privatised plants continued to be less efficient compared to the private sector cement firms in terms of labour productivity in the first phase of post-privatisation.

Individually, five cement plants showed an impressive performance in labour productivity after their privatisation. The highest labour productivity is recorded by Söke Çimento, followed by Ankara and Trakya. As Table 6.5 shows, cement output per worker in Söke increased from 902 tons in 1989 to 4,763 tons in 1995, whilst the cement output for Ankara and Trakya reached 3,314 and 3,284 tons respectively in 1995 from around 1,400 tons per worker in 1989. It is expected that the trend of increasing OUTEMP would continue in line with the new investment has been made by SET Group in capacity increase and new technology.

The evidence regarding labour productivity clearly suggests that privatisation had a significant effect on the labour productivity of the five privatised cement plants. These five plants were able to produce a better outcome in terms of GVA and SALEFF per employee at constant prices as well as output per employee (OUTEMP) than their public counterparts, especially in the post-privatisation period of 1992-94,

whilst improvement in labour productivity is much more significant for the private sector cement companies in the period concerned. The outcome of the productivity measures employed is somehow an apparent contrast to the figures related to other financial measures such as rate of ROS and ROA if one compares them to the figures for the privatised, private and public cement firms. The reasons for the improvements in labour productivity and failure to produce better financial profitability figures are not clear yet.

As Karatas (1995) points out this increase on labour productivity can be related to a reduction in the number of employees as a result of a new employment policy pursued by the current management. Another explanation may be that, although five cement plants were privatised in 1989, it is unlikely that the change in ownership had any immediate effect on performance especially on financial profitability. In fact, this sounds like a more reasonable justification. Given the court challenge, it may even be argued that the performance of these privatised companies suffered as a result of privatisation. Anecdotal information by labour union members and public sector administrators as well as other experts in the field indicates that the change in ownership did cause some managerial difficulties and even loss of performance at the privatised cement plants at the early stage. Most of the comments indicated that the new owners did not understand the peculiarities of the individual cement plants or markets, and the result was bad decisions. Yet these claims were publicly denied by the head of SCF's East European Division, Mr. Grinfeder. He stated that "We [SCF] didn't know the market, but we knew our product" (*FT*, 18.11.1992). The Company management accepts the fact that early problems with the sale of the five cement plants affected their strategy but it disagrees that this is the only reason for unsatisfactory performance. The management of the company argues that poor

profitability rates in the post-privatisation and low productivity rates in particular in the early stages of the post-privatisation period, are much more related to the investments and modernisation efforts and hence the high cost of investment made and the loss of production lines at the cement plants during the early 1990s.

The SET Group points out that SCF modernised and automated the production system in its most plants. The production system in Afyon plant, for example, is now fully automated and controlled from a control room. Ankara Çimento had an installation of a new 450 thousand ton year capacity kiln. Modernisation investments in Balikesir Çimento was completed and a truss mill was installed. Trakya Çimento also had a new precalcination system and new mill with investments after its privatisation in 1989. Thus, during these modernisation works, the management insists that some of the plants worked with the half of their usual capacity which consequently affected the financial performance and the output level of the five privatised firms between 1989 and 1995 (personal interview, 1995; Satiroglu, 1995).

Finally, in terms of cost efficiency, the five privatised cement plants have been able to reduce both the annual average cement price and cost of cement per ton significantly in the post-privatisation period. As shown in Table 6.9, the annual average price of cement dropped to $42 per ton in 1994 from around $60 in 1990. The annual average cost of cement production for SCF plants also declined from $49 to $31 per ton in the same period. This represents about a 30 per cent reduction in cement prices and a 30 per cent cost cut in cement production in the period of 1990-94 (Satiroglu, 1995, p.4).[14]

[14] The study of Çelebi (1995, p.105) also shows that the five privatised cement firms were able to reduce their production costs despite a 60 percent increase in the level of wages in real terms from 100 in 1989 to 156 in 1994. However, it does not state any percentage how much this reduction is.

Table 6.9: Cement Prices in Turkey, 1988-1994

	SCF Annual Average Cement				Annual Average Cement Prices in Turkey (*)	
	Unit Price ($/Ton)		Unit Cost ($/Ton)		1987=100 (TL/Ton)	
1988	n.a.		n.a.		356.9	
1989	n.a.		n.a.		336.7	
1990	60		49		382.8	
1991	54		44		362.6	
1992	57		46		356.9	
1993	56		42			
1994	42		31			
Annual Average Change for	***1990-94***	***-30%***	***1990-94***	***-31%***	***1988-92***	***+1.1%***

Note: (*) This column represents annual average cement prices (without VAT) between January and December in Turkey provided by the Turkish Cement Producers Association. The current annual average cement price for each year was converted into constant price by using consumer price index (CPI) based on 1987, and then the annual average increase of cement price in real terms for the period of 1988-92 was calculated; n.a.= not available.
Source: PA (1994); Satiroglu (1995, p.4), SPO (1993, p.66) and *Dunya*, 22.6.1994.

It seems as if price competition also embraced the other cement producers in the country. Competition in the western part of the country and around the large urban markets, in particular, seems to be much stronger now because of the increase of cement producers including several foreign firms which entered the Turkish market with privatisation and the threat of imported cement. Furthermore, improving roads and reducing transportation costs in some parts of the country now encourage cement producers to break into the neighbouring markets as happened in the first quarter of 1990. Cement producers in the Izmir region attempted to break into the large Istanbul market causing a brief price war. However, the cost of transport and lack of a good road system, especially in the less developed part of Turkey, have proved to be a disincentive for cement companies to intensify competition further and to extend competition to these regions which might have possibly resulted in increased consumers' benefits with lower cement prices.

Table 6.9 shows the rate of change in annual average cement prices in Turkey from 1988 to 1992. According to this, there is a 5.7 per cent drop in real terms in annual

average cement prices in 1989. Even though the rate of change of annual average cement prices is up again in 1990 with about 14 per cent increase, annual average cement prices have not increased significantly in the period of 1988-92. As Table 6.9 indicates, the annual average cement prices in real terms increased by only 1.1 per cent between 1988 and 1992 in Turkey. Cement prices seemed to be increasing after 1993 as a result of increasing cost of main production inputs. For example, the annual average cement prices were TL750-800,000 per ton in current prices (about TL375 in constant 1987 prices) in 1993 while the cost of cement per ton reached TL1,750,000 in current prices (TL398 in constant 1987 prices). The cement producers explained that the cost of main inputs of cement production such as electricity, coal, petrol, gas and labour, was much higher than the increases in cement prices. The cost of imported coal and gas based on a dollar, for instance, increased by 150 per cent while electricity was 65 per cent more expensive in 1994. However, it is claimed that cement prices did not increase significantly, partly due to price cuts by the cement producers to keep the falling demand for cement steady in economic crisis of 1994, and partly, thanks to the competition in the sector. In fact, it is argued that the rate of increase in cement prices is still less than the prices of other products used in construction industry such as iron, steel and tile (*Dünya*, 6.6.1994, p.3). The falling trend of cement prices in real terms has apparently led to calls for monthly price arrangement at the end of this year. The chairman of the Turkish Cement Producers Union, Mr. Çelenk, said that cement prices had remained behind the inflation and claimed that the monthly price increases were needed. He then claimed that cement costed $60 per ton in 1993 but it costs $52 today compared to cement prices in Europe which are between $70-110 per ton (*Dünya*, 18.11.1997).

6.6 Conclusion

In this chapter, the case study of privatisation in the Turkish cement industry has been examined. An assessment of the performance of the five cement firms privatised in 1989, is presented and then a comparison of the five privatised cement plants with both the public and private sectors covering the period of 1986-1995 has been made.

It is argued in the literature available that the public sector companies are less efficient than the ones from the private sector, and that privatisation by changing the ownership of the enterprise will increase its efficiency and will improve its profitability and productivity. The results of the analysis made in this chapter, however, do not fully support this argument.

The analysis of the relative efficiency of public and private sector cement firms shows that Turkish private sector cement firms have certainly a clear edge in relation to the public cement firms according to the profitability and productivity measures employed in this study. In Turkey, the private sector cement firms doubled their profitability and productivity compared to the public sector firms during the period observed. However, before privatisation, the Turkish cement industry was relatively competitive with the presence of public, private and mixed cement companies. Competition was especially significant in the western part of the country where three types of ownership (i.e. private, public and mixed), in the cement sector existed. The public sector firms (especially five privatised plants examined) operating in relatively competitive markets before the privatisation (i.e. 1986-88), showed statistically very little difference in terms of profitability compared to their private sector counterparts but their productivity performance was still clearly below the private cement firms.

In the post-privatisation period, the five privatised cement plants have shown a rather poor financial performance up to date, even below the average of the remaining

public sector cement plants. However, the financial measures of efficiency employed (e.g. profitability, return on assets and equity) can be misleading in economies with a high rate of inflation. Furthermore, accounting and reporting standards are still weak, and cheap loans from government sources for the privatised cement firms no longer exists. The common characteristics of the privatised cement firms (including the five cement plants examined in this chapter) is that they all required new investment. Thus, the new owner of the five plants, SCF, had to invest a considerable amount of money for capacity increase, modernisation and pollution preventive systems. As the management of the SET Group mentioned, their investment has meant incurring further costs. The high cost of borrowing in an economy where high inflation persists, has led to a relatively poor financial performance in the five cement plants (personal interview, September 1995).

In contrast to the financial measures of efficiency, the labour productivity figures show a completely different picture. Production per employee at the five privatised cement plants is more than twice than that of the Çitosan's remaining plants but it is still below the private sector cement plants. As shown in Tables 6.5 and 6.6, the production of cement per employee in the five plants increased to 2,584 tons in the post privatisation period from 1,181 tons in 1986-88 period, whilst the average output per employee for the private sector and the remaining public cement plants was 3,627 and 1,159 tons per year respectively in 1994.[15] Other productivity measures employed (SALEFF and GVA per employee) also reveal an increased efficiency in productivity following the privatisation.

Some relate this significant improvement in productivity to two main factors; reductions in labour and automation investments in the privatised cement enterprises

[15] These figures are calculated by the researcher from different sources cited earlier.

(Tallant, 1993; Karatas, 1993; Treasury, 1995). As discussed earlier, it is estimated that the Turkish cement sector has reduced its labour force by one third since 1990, mostly in response to large increases in real wages. The rate of reduction in labour force is even greater (50%) in the five privatised cement firms in 1989-94 period (SPO, 1993; PA, 1994).

The privatisation of the cement sector which started with the sale of five cement plants to SCF, and the participation of domestic and foreign cement firms in subsequent privatisations in the sector brought about further beneficial spill over effects to the cement sector in Turkey. To a certain extent, the foreign cement firms seeking to acquire a market share from Turkey's large and still relatively underdeveloped local market, can be seen as a catalyst for the changes that occurred, at least in two respects; new investments made and new products introduced.

Firstly, it looks as if the privatisation of the cement sector has stimulated much required new investments. The SET Group has invested over $300 million since 1989 and other domestic and foreign cement firms have followed the same trend (SPO, 1993, p.93-98; *Dünya*, 6.6.1994). In order to face the new competition and to stay competitive, since the early 1990s, the large domestic producers have been trying to modernise their production facilities, to increase their production quality and quantity, and to cut cement prices. As one of the largest Turkish cement producers, Sabanci, admits "foreign competition... has forced the local companies to diversify their product range and make investments which they might otherwise have postponed" (cited in *FT*, 18.11.1992).

Secondly, the leading role and initiations of the foreign cement firms seem to have been effective in promoting new products in the Turkish market too. Ready-mixed cement production and prefabricated concrete, for instance, have become a fast

growing market activity for most cement producers in the country. This was something not very well accepted previously as part of cement activity in the Turkish market at all.

However, one of the key questions which needs to be highlighted is whether the privatisation of the cement sector has created regional monopolies. Even though early privatisations carried out in the sector were in competitive markets, the creation of regional monopolies with the privatisations realised in less competitive markets is of great concern to some. Indeed, as shown in Figure 6.1, cement companies have largely been successful for bidding on cement plants close to their existing operations. Hence it looks as if this has, to a certain extent, created a concentration of ownership in the hands of certain holding companies or families, in particular, in less developed and less competitive eastern regions of Turkey.

Critics of the privatisation of the cement sector argue that regional monopoly concentration is the results of the government's willingness to maximise the privatisation revenues and the PA's bidding process which fails to screen potential buyers. They further claim that the increased size of regions dominated by a single or two companies will lead to higher consumer prices, greatest profits and probably a loss of efficiency in the sector (Özpelitoglu, 1994; Çobanoglu, 1994).

Some experts and managers in the cement industry, however, do not agree with the above claims. They justify biddings made for neighbouring cement plants on the grounds of managerial efficiency, and they expect that further economies of scale will lead to greater productive efficiency thereby to lower consumer prices.

It is too early to determine whether privatisation in the cement sector has increased competition and reduced cement prices and, how this has affected the performance of the cement plants studied. The existing evidence suggests that despite

the tendency to create regional monopolies in the eastern part of the country, most cement firms in the western part of Turkey are operating in a relatively competitive cement market. Competition in the western part of the country and around the large urban markets seems to be getting stronger, mainly due to the increase of cement producers including some foreign firms and the threat of imported cement.

In summary, today, the cement sector in Turkey operates with more than 15 domestic and three foreign cement producers. The privatisation of the sector which has been so far the most extensive one in the country, looks as if it has had some beneficial effects, or at least it has played a catalyst role, for bringing some benefits to the sector such as new investments, new products and increasing competition in the western part of the country and around large urban areas. Yet, by looking at the level of average annual consumption and rising demand in the housing sector, it is possible to predict that the demand for cement will continue to rise in the country. It remains to be seen whether consumers will be the beneficiaries of the increasing competition, in terms of lower prices, higher quality and more varied cement products, among privately owned cement firms in the near future.

CHAPTER 7: Assessing the Performance of An Unregulated Privatised Monopoly: USAS

7.0 Introduction

The purpose of this chapter is to examine the economic performance of USAS, an airline catering company, following its privatisation. USAS was one of the public enterprises which was privatised in 1989 through a block sale to SAS Service Partner.[1] Later in 1993, with the sale of 30 per cent of the remaining shares of the company in the stock exchange, USAS became a fully privatised company.

With the privatisation of USAS, the government aimed at increasing the quality, quantity and diversity of goods and services given at the Turkish airports. It was expected that privatisation would bring USAS 'up to international standards in its services' with the new technology and know-how owned by SSP, and would diminish its monopoly position by opening up the company to market forces.

This analysis compares the performance evaluation of USAS in the pre and post-privatisation periods by using financial measures such as profitability, rate of return on equity and assets, total sales per employee, and physical measures such as labour productivity per employee. It will be also examined how many of, and to what extent, the above stated objectives have been achieved as a result of privatisation.

7.1 USAS Before Privatisation

USAS (Uçak Servisi Anonim Sirketi) was established in 1958 to provide catering service for the domestic and external lines of Turkish Airlines (THY). In

[1] SAS stands for Scandinavian Airline System, and SAS Service Partner located in Denmark, will hereby be called 'SSP'.

1984, the Company became a SEE and then it was transferred to the PPA for its privatisation in 1987. Prior to its privatisation, USAS was a service company providing ground handling and catering services at major Turkish airports primarily to foreign airlines. It also used to operate airport food services, bus service and travel agencies. The market which USAS was operating can be described as follows:

In 1984, USAS had over 1600 workers and it was providing services to four airports and 10,126 aircraft (Morgan Bank, 1986). As the Morgan Bank Report (1986) indicates, in 1984 THY flights accounted for about 60 per cent of the airport traffic in Turkey, and THY had its own ground handling service. The remaining market was shared by USAS, and Çelebi Hava Servisi A.S. (hereafter Çelebi), a small ground handling company competing with USAS at Ankara and Istanbul airports on scheduled flights only. USAS was enjoying its virtual monopoly position on non-scheduled (charter) flights which then accounted for more than half of Turkey's non-THY commercial air traffic. More importantly, USAS had a monopoly in catering services for all airlines including THY.

As indicated in the Morgan Report, more than half of the aircraft landing in Turkish airports were charter flights and the Ministry of Transportation required their handling to be carried out exclusively by USAS. As a result, the other ground handling company, Çelebi, was able to compete only in the remaining half of the market. Evidently, THY was not allowed to offer services to other airlines; therefore, USAS enjoyed a highly protected market position.

Further government involvement was stressed by the Morgan Bank Report. It said that the Ministry of Transportation set up prices to be charged for all handling services in Turkey and it regulated entry into the market. Thus price competition was not allowed. It was clearly underlined in the Report that these prices were quite high

compared to prices charged for similar services at airports in other countries. It followed that USAS's monopoly position made the company very profitable. The total revenues of USAS in 1984, for example, was around $20.7 million while its reported operating profit was $10 million (Morgan Bank, 1986, p.29). Even though the operating profit of the company dropped to $6 million in 1985, USAS was still considered as highly profitable and viable in the future. This is, in fact, a reasonable outcome when one considers the heavy government involvement in regulating the industry in terms of setting the prices to be charged and entry into the market.

Despite these favourable characteristics, the Morgan Report found that "the quality of USAS services was low when compared to Çelebi and to international standards" (p.30). Services suffered in that period of time because of the lack of experienced staff and dynamic management to take proper decisions, and government regulations which gave USAS a slow response time.

7.2 Privatisation of USAS

The preliminary privatisation report done by the Morgan Bank considered USAS as "a good candidate for privatisation" (p.31). According to the Report, USAS represented an attractive investment because of its large share of a high-growth market. The Report noted that air traffic in Turkey was expected to grow an 8 to 10 per cent per year during the late 1980s and the early 1990s, and USAS had then over 80 per cent of the market (excluding THY). Moreover, before its privatisation, the company was also very profitable. It was anticipated that the profitability of the firm would continue but one should bear in mind that if more competition was allowed by the government in the sector, the firm might be less profitable in the future.

The Report's assumption on USAS's profitability was based on the ratio of operating profit to total invested capital which averaged 160 per cent from 1981 through 1984 (Morgan Bank, 1986). Much of this high profitability was attributed to the high prices charged as a consequence of its monopoly protection and low labour costs compared to its European counterparts. The Report emphasizes several times that much of USAS's profitability and market share were the result of government regulation. The high prices set by the government and the company's monopoly position in ground handling for non-scheduled flights and in catering for all flights were the result of the protection given by the Ministry of Transportation. Since the goals of privatisation include increasing competition and economic efficiency, the Morgan Report states that:

> ... it may be advisable for the government to decrease the level of protection afforded USAS either before or concurrent with the sale of the company, even if such reduction would also decrease the attractiveness of the company to potential investors (1986, p.31).

The Report suggests that maintenance of a monopoly in this sector is inconsistent with the government's main privatisation objectives which are (in order of importance); (1) to allow market forces to stimulate the economy; (2) to increase productivity and efficiency; and (3) to increase the quality, quantity and diversity of goods and services. Therefore, the government should eliminate USAS's monopoly over time. The removal of USAS's monopoly should begin concurrently with privatisation, but this should be phased out only gradually.

In order to decrease the protection given to USAS, it was suggested that the government could deregulate prices (or at minimum, set ceiling prices but not floor prices), and remove the company's monopoly in catering and in ground handling for non-scheduled flights. The Report clearly did not recommend, however, that the government should allow THY to compete directly with USAS for the ground

handling business of foreign carriers. It is argued that "THY would likely have such a strong competitive advantage vis-à-vis USAS as to threaten the viability of the company" (p.31). Additionally, it is also suggested that opportunities existed for USAS to increase its diversification into other travel-related businesses to take advantage of Turkey's ongoing tourist boom.

The Morgan Report proposed three possible privatisation options for USAS; (i) sell USAS as a whole, (ii) sell USAS as two companies, one for ground handling and one for catering, and (iii) immediate deregulation in the market. The Report also highlighted the possible pros and cons of each privatisation option and it made suggestions about the measures needed to be taken following the privatisation such as monopoly protection for sometime, and price deregulation. Today it is apparent that the second privatisation option was chosen by the government. The government decided to split the company (i.e. USAS) into two. The sector was restructured for privatisation by the government with the establishment of two separate companies, a ground handling company (HAVAS) and a catering company (USAS). After the split up in 1989, the new USAS company was assigned to provide catering services while HAVAS started to operate as a new ground handling company at Turkish airports. Nevertheless, HAVAS was also subsequently privatised by selling 60 per cent of its shares to a domestic investor in August 1995 for $36 million (Intermedia, 1995, p.42).

It seemed that the suggestion made by the Morgan Report was influential in this decision because the Report pointed out that during the interviews with the potential buyers, the international companies showed more interest in USAS's catering business than in the ground handling business. Thus, the Report suggested that a majority stake in the new catering company might be sold to an international inflight catering company while the new ground handling company might be sold to a Turkish

company or to a consortium of foreign airlines. By doing this, it was expected that the new international inflight catering firm would significantly improve the quality of service given in major Turkish airports.

It is remarked in the Morgan Report that USAS is not a good candidate for share sales in the capital market because (a) it is a relatively small firm; (b) the company is not well known to the general public and does not enjoy a good reputation and (c) the possibility of significant changes in USAS's regulatory environment may reduce the attractiveness of the company's shares.

In February 1989, however, 70 per cent of USAS's shares was sold to SAS Service Partner which is a company within the SAS Group of Companies located in Denmark. Then the new owner, SSP, was operating restaurants and providing catering services at airports, big stores, motorways, hospitals and exhibitions. SSP was providing all these services in eleven countries including the USA, Japan, England, Germany, Spain, Sweden and Norway and had more than 7,000 employees (Karatas, 1990, p.48-9).

The PPA had $14.4 million from the sale of USAS. According to the sale agreement, (i) 70 per cent of USAS's TL10 billion nominal capital value will be transferred to the SSP for $14.4 million, (ii) the SSP will guarantee to pay 21 per cent of its profits after-tax to the PPF for the 10-year period from 1989 to 1999, (iii) in addition to that, both parties also agreed that 30 per cent of the nominal capital, after a certain period (not exactly defined), will be sold to private individuals, first priority to be given to employees of USAS.

Despite the fears of the PPA, the monopoly position of USAS was lifted before putting up the company for 'tender offer'. It was clear to the PPA authorities that

lifting the monopoly position of USAS was a disadvantage which might pose some significant risks to bidding companies and thus cause the bidders to offer relatively lower prices. However, it is claimed by Ms. Varli in the Privatisation Administration that in spite of the elimination of USAS's monopoly power, the best price was obtained from the sale of USAS to SSP (personal interview, September 1995).

It is possible to view the privatisation of USAS as a test case for the Turkish government after the eventual failure experienced in the case of Teletas. The Turkish government attempted to put the privatisation back on track by reversing the increasing trend of criticism. The government's aim with the sale of USAS was to prove that privatisation in Turkey could be successful. It was stated by Professor Gültekin, head of the PPA then, that:

> one of the goals in the USAS privatisation was to bring this enterprise up to international standards in its services extended to THY and other airlines, and to enable it to acquire new technology and know-how to develop its structure (cited in Karatas, 1990, p.48).

It is evident here that the PPA shared the belief that USAS, with its present features, was not suitable for sale to private individuals. It is believed, however, that the new owner SSP, after improving USAS's organisation and management and raising its profitability as assured, will be able to prepare USAS for its partial sale to private individuals in the very near future. Another relevant question is whether the SSP will be prepared to undertake new investment to expand the services of USAS. On this issue, the understanding of the PPA authorities is that within the next five years SSP will undertake new investments up to $6-8 million, perhaps including investments in tourism and hotel industries (Karluk, 1994, p.216).

When the sale of USAS was announced, the PPA had to face intense criticism both from the public and from the opposition parties in the parliament. They argued

that USAS was sold below its real value and the company was turned into a private monopoly which would bring very negative implications in the long run. The criticism was intensified so much that, the main opposition party, TPP, took the USAS's sale to the High Court, and demanded that the deal should be cancelled because of the reasons stated above (Kafaoglu, 1994, p.134; Çelebi, 1995, p.101).

However, the PPA stood firm against public criticism and strongly argued that the deal was skillfully negotiated and it was very beneficial as far as USAS and the industry were concerned. The PPA tried to persuade those sceptics by stating that one obvious advantage of the new owner, SSP, was its 'distinct specialization and managerial superiority in airport management'. Professor Gültekin remarked that the SSP possessed a remarkable technology and wide experience in the field of catering and that the SSP's operation of the USAS company would eventually change the servicing quality of Turkish airports. He also added that, by collaborating with THY and DHMI (State Airports Administration- hereafter SAA), SSP would be capable of bringing Turkish airports up to international standards (Karatas, 1990, p.48-9).

In October 1993, the PPA offered 30 per cent of the remaining B group shares to the public and shares were bought by more than 4,672 small investors. PPA generated $15.2 million revenue from this sale (Intermedia, 1995, p.45; PA, 1996). The shares of USAS have been trading on the ISE since October 1993. Presently, USAS is a fully privatised airline catering company operating in six major Turkish airports.

7.3 Developments in the Global Airlines Industry

During the analysis of the USAS's performance, it has become clear that there are a number of issues which need to be addressed. For instance, it may be more appropriate to assess USAS's economic performance in the context of changing

circumstances of both global and Turkish airline carriers industry, and see how much these developments have affected the business activities of USAS, and thus its economic performance examined in this chapter.

To start with, the falling demand for USAS's services should be assessed in the context of the falling income of airlines and the falling ticket prices in the global airline carriers industry. Profitability in the airline industry has been badly affected by the fall in ticket prices in the past years. This is mainly due to the deregulation in ticket prices in the US and the increasing competition on ticket prices in Europe. The falling demand for many airline carriers following the Gulf War forced airlines to cut costs, and to restructure and consolidate their operations in order to survive and remain competitive in the years ahead. Thus, especially for the European airlines, the strategy has been to choose cheaper catering products because of the falling demand in their business and fewer first class passenger (Andrieu, 1993).

It is, therefore, not difficult to generalize that while developed country airline markets have recorded either a declining profitability or stagnation in profitability, there is evidence of increasing growth in the developing country markets. In particular, European airlines tried to recover or lessen the losses in their revenues by reducing the expenses on catering services for their customers.[2]

In contrast to the stagnation of airline markets in developed economy countries such as the United States, Europe and Japan, the Turkish airline sector has grown an average 13.5 per cent per annum since the early 1980s. The rate of the average increase is even higher than the one predicted by the Morgan Bank in 1986.

[2] It is estimated that the long term forecast of aggregate demand is optimistic and the annual growth rate would be around 5-6 per cent per annum. This rate, however, would be as high as 8-9 per cent in developing areas with a high growth rate while it may remain around 4 per cent in more matured and saturated markets of North America and Europe (Andrieu, 1993, p. 4).

Furthermore, almost all the indicators (e.g. the number of passengers, flights and number of seats in those flights) in airlines and the terminal catering market in Turkey have been positively good in the 1980s and 1990s. However, it is obvious that there are still some ups and downs in the Turkish airline sector. The Gulf War in 1990 and a strike which lasted 38 days in THY in 1991, for instance, reduced the level of domestic and international air traffic a 16 and 27 per cent respectively.

Table 7.1 below shows the total number of passengers in the six busiest airports in Turkey between 1983-1993. The total number of domestic and international passengers increased more than 3 million in the early 1980s and reached 8.5 million in 1987 from 5.1 million in 1983. This trend continued in the following years and the total number of passengers using the six major airports in Turkey reached 15.9 million in 1992, and it was estimated that this figure would be around 18 million at the end of 1993.

Table 7.1: Domestic and International Airline Passengers in Turkey ('000), 1983-1993

Airport	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993(1)
Istanbul	2,913	3,605	3,505	3,754	4,587	5,449	5,840	6,233	5,205	7,371	6,294
Ankara	1,193	1,364	1,320	1,262	1,570	1,632	1,688	1,973	1,689	1,142	1,188
Izmir	577	631	674	835	1,164	1,461	1,570	1,716	1,239	1,968	1,761
Antalya	112	138	138	313	607	993	1,412	2,107	1,565	2,735	2,086
Dalaman	40	57	82	161	314	610	630	705	620	1,184	1,011
Adana	279	292	256	274	315	349	338	420	331	499	440
Sub-Total	**5,114**	**6,087**	**5,975**	**6,599**	**8,558**	**10,494**	**11,479**	**13,154**	**10,630**	**15,900**	**13,481**
TOTAL(2)	**5,391**	**6,137**	**6,327**	**6,872**	**8,903**	**10,838**	**11,843**	**13,629**	**11,019**	**16,495**	**20,664**

Note: (1) The figures for 1993 include only Jan.-Aug. 1993; (2) The figures in 'Total' show the total passenger traffic at the all Turkish airports whilst the sub-total figures indicate the number of passengers in the six airports (which is more than 95% of the total) where USAS operates. The number of passengers in the Turkish airports are 22.3 million in 1994 of which 60% of them are international air passengers.
Source: PA (1993, p.15); SIS (1996).

The growing trend in the Turkish airline sector owes much to booming tourism, the increase in domestic purchasing power, the integration of the Turkish economy

with the European economies, and to a lesser extent to the war in the former Yugoslavia in recent years. The sector, especially in the last two years, showed an excellent performance by increasing its international airline passenger traffic by 57 per cent in 1992 and by 27 per cent in the first eight months of 1993, while domestic air passenger traffic increased 39 per cent in 1992 and 32 per cent in the first eight months of 1993. The statistics based on the SAA and SIS data show that the number of passengers in international flights was about 11 million in 1992, and it is expected that this would rise to 35 million in the year 2000 providing an average increase of 16 per cent in the Turkish airline sector each year (PA, 1993, p.15).

There were 21 civil airports in Turkey in 1992, and some military airports have also been opened to civil flights in recent years, but, they are largely used for domestic flights and they do not represent any significant proportion in the total number of civil flights. Almost all the international flights and 90 per cent of domestic flights use the six airports where USAS operates for their arrivals and departures. Eight of the 21 civil airports are also used for international flights and international flights represent 65 per cent of all passenger air traffic in Turkey.

7.4 What Happened to USAS after Privatisation?

The previous owner of USAS, SSP, decided to change its business strategy in regard to its catering activities and sold its secondary activities such as the contracted catering and the airport catering services section to a British company, Compass Plc., in July 1993. SSP took this decision mainly due to the falling revenues in airline industry and deregulation of airline ticket prices (PA, 1993, p.6-7). A year later, in 1994, SSP also sold USAS to Gate Gourmet, a subsidiary of Swissair.

Gate Gourmet, is one of the largest and a very well-known airline catering company in the world at the moment (*Bülten*, 25.9.1994). The sale of USAS to Gate Gourmet has been welcomed by the management of USAS. The General Manager of USAS, Mr. Hertel, expressed his opinion by saying that:

> The sale of USAS to Gate Gourmet is delightful firstly because Gate Gourmet is the largest and a very well-known company in airline catering. Secondly, Gate Gourmet is owned by Swissair, and Swissair has lots of money and that may mean new investments in USAS by the new owner. Finally, USAS is already an international firm and hopefully this sale will bring further recognition of USAS in the international market (personal interview, September 1995).

Currently USAS gives catering services to the airlines and provides catering facilities at the six busiest airports in Turkey. The revenues of the company come from the sale of catering products to domestic and foreign airlines, and services provided at the terminal restaurants at the airports. The company report indicates that 70 per cent of the total revenues consisted of airlines catering and the rest was achieved from terminal restaurants (ISE, 1995, p.1064).

The company runs cafes, cafe-bars, snack-bars, restaurants and shopping units in domestic and international sections of six airports: Istanbul, Ankara, Izmir, Antalya Dalaman and Adana. It provides a variety of foods and drinks from Turkish and international cuisine. Due to the increase in the number of foreign tourists visiting Turkey in recent years, first of all, the company started in 1990 to provide new products which target the taste of foreign visitors, and secondly the company has been renovating its catering facilities at some airports such as Ankara Esenboga airport in order to meet any increase in demand in the future (ISE, 1995, p.1063).

The company serves airline catering services to the domestic and foreign flights at the six above mentioned airports and the greatest percentage of USAS's revenues is generated through these services provided to airlines. The premises where the

company operates have been either leased from the SAA for a period of ten years or the company uses some other premises located around the airports. The demand for the company's airline catering services comes mainly from domestic airlines, predominantly THY. The other domestic and international airlines also require regularly the services provided by USAS. The company presently serves more than 40 airlines landing in Turkish airports. In addition to the scheduled flights of these airlines, USAS also caters for domestic and international non-scheduled airlines.

The biggest customer of the company is still THY. THY's flights represent 88 per cent of all scheduled flights in Turkish airports while USAS's sales to THY within its total sales were 51 per cent in 1992 and 66 per cent in the first seven months of 1993. Furthermore, USAS's 55 and 51 per cent sales revenues in 1990 and 1991 respectively came from the catering services given to THY (PA, 1993, p.10). However, this business relationship has its own disadvantage too. The trend of USAS's revenues depends very much on THY's demand for its airline catering services. Thus, any delay on payments to USAS by THY affects the company's cash flow seriously.

It should also be noted that the demand for inflight catering services depends on certain factors such as price, quality, reliability of service and distance of flights. In general, scheduled airlines, but, in particular, international airlines which have a good reputation for their customer services and airlines which are relatively expensive in terms of ticket prices, demand from airline catering companies such as USAS high quality catering services, hygienic standards, and reliable distribution and punctual delivery. In contrast, non-scheduled airlines (charter) and airlines which sell low price tickets set their inflight catering demand according to the prices of the services provided. They usually order simple and cheap menus.

Table 7.2 below provides the data for the number of meals served by USAS between 1990 and 1995 at the six airports where it operates. Table 7.2 shows that the production of served meals declined 45 per cent in 1991 compared to the figures of 1990. The strike which lasted 38 days on THY in 1991 was a significant factor in this reduction. This development also had an severe impact on the employment policy of USAS.

Table 7.2: Number of Meals Served by USAS, 1990-95

Airports	1990	1991	1992	1993	1994	1995
Istanbul	3,356,929	2,109,664	2,912,518			
Ankara	1,171,323	401,432	627,390			
Antalya	403,926	313,296	606,796			
Izmir	817,312	336,584	615,508			
Adana	208,743	77,984	189,119			
Dalaman	94,139	56,243	175,390			
TOTAL	**6,052,372**	**3,295,203**	**5,126,721**	**6,992,778**	**9,370,323**	**10,963,279**

Note: (*) The data for each airport for the period of 1993-95 and for the pre-privatisation period is not available.
Source: PA (1993, p.10); *Dunya*, 4.8.1995; ISE (1996).

According to the sale agreement, USAS was prohibited to make a reduction in its labour force of more than 10 per cent in the first year following the privatisation. After that it has been allowed to reduce the number of employees, if it wishes, by 5 per cent each year until 1999 with the consent of the PPA. Despite the conditions in the agreement, the company and the PPA agreed on reducing USAS's labour force by 40 per cent. This significant cut in workforce was mainly due to a crisis in the airline sector resulting from the Gulf War in 1990 and the strike of 1991 in THY which consequently led to a sharp fall in demand for the company's services. Thus, over 500 people in USAS were made redundant and this reduced the number of employees from 1,276 in 1990 to 770 in 1991.

These redundancies arose from a number of specific reasons such as a decrease in the level of economic activity, resulting in declining sales and overcapacity and temporary problems in the industry within which the USAS is located. However, the management of USAS claims that it made new investments following the privatisation to improve the quality of its services and products. The introduction of technological change within the company such as new automated washing up belts and packaging systems which started at the beginning of 1990, resulted in a requirement for less manpower to produce a given level of output. The management argues that technological developments within the organisation are also often accompanied with a change in the level or type of skills required amongst the employees. As a result, some employees were made redundant because they had neither the skills nor the ability needed by the introduction of new technology in the company.

Representatives of TOLEYIS[3] were not surprised with this massive redundancy. One trade union officer commented that this was one of the results of the privatisation of USAS bound to happen sooner or later. After emphasizing the problem of excess labour in most SEEs, he explained that:

> Before the privatisation, USAS was a profitable but not a productive public enterprise like most public enterprises in our country. There were about 1800 employees who could only produce 4-5 thousand meals per day with very poor standards and limited variety. Today the company is able to produce 25-26 thousand meals per day with 900 employees. We believe, as Toleyis, that this considerable increase in production is good for everyone. This is the type of privatisation that our country needs and which we welcome and give our full support (personal interview, January 1996).

The production of the company, however, started to grow again in 1992 with an increase of 56 per cent, and amounted 6.9 million meals in 1993. A similar trend was also observed for the number of employees which increased the total number from 770 in 1991 to 837 employees in 1992. The number of meals served was around 9.3

[3] TOLEYIS is the abbreviation of Hotels, Restaurants and Amusement Places Workers Union.

million in 1994 and 10.9 million in 1995 (PA, 1993, p.11; *Dünya*, 4.8.1995; ISE, 1996). Moreover, USAS produced and served more than half of its total meals at Istanbul Airport which corresponds to the number of passengers who used this airport in the same period (see Table 7.1). The share of non-scheduled airlines in inflight catering represents about 15 and 18 per cent in 1990 and 1992 respectively. In 1991, when the demand from THY declined radically due to the 38 day strike, the share of charter flights went up to 28 per cent in total demand for USAS flight catering services.

In a news conference, the general manager of USAS, Mr. Hertel, stated that the performance of the company will be taken forward in 1995. Mr. Hertel reckons that over 23 million passengers will have used the Turkish airports by the end of 1995, and it is estimated that 12.7 million of them will require the services of USAS's restaurants and shops (*Yeni Yüzyil*, 19.19.1995).

7.5 Analysis of Economic Performance: Profitability and Productivity of USAS

The analysis of USAS's performance shows that since its privatisation in 1989, the company became a very successful private enterprise. The performance of the company seems to have improved considerably in terms of the profitability and productivity measures employed for the analysis of the company. Some analysts have even nominated USAS as "one of the best performing and managed companies of 1994 in the Istanbul Stock Exchange" (*Paratüyo*, 13.11.1994). Furthermore, it is widely accepted that USAS has also improved the quality and diversity of the services provided at Turkish airports and brought them up to international standards.

The sales and profitability of the company have been increasing steadily since 1990. Despite the impact of the Gulf War on airlines in 1990 and thus on the airline

catering sector, and the strike in THY in 1991, USAS has been successful in increasing its profitability and productivity over the years following its privatisation in 1989. The Company's net sales increased to $80.8 million in 1994 from $29 million in 1989. It is possible to observe the same trend in the pre-tax profits which increased to $55.7 million in 1994 from $4.5 million in 1989. Furthermore, a detailed analysis of data about USAS shows that all the major components such as sales, profits before tax and labour productivity, have been steadily growing in the past six years.

Comparable data about USAS for the period 1982-1995[4] is presented in Table 7.3 and Table 7.4. Table 7.3 consists of five different measures of performance for USAS, starting from 1982. Even though the available figures for the pre-privatisation period look much higher than the post-privatisation ones, one should be careful in the interpretation of these figures for two reasons. First, the figures up to 1989 consist of the ground handling services of USAS which were separated just before its privatisation. As indicated earlier, alongside its monopoly status in airlines catering services, USAS was holding a major stake in ground handling services at major Turkish airports. Second, it is not clear what kind of accounting techniques were used for the provision of the data. However, the data starting from 1990 do not raise the same doubts as those relating to pre-privatisation because of the tight ISE requirements on company accounting standards for the companies listed in the Istanbul Stock Exchange.

The study of Karluk (1994, p.216) shows that USAS's total revenues were $25.3 million while its pre-tax profits were $12.4 million in 1988 prior to the privatisation. The total equities of USAS was $23.3 million in the same year. These figures

[4] Dropping the years 1985-87 where no regular and consistent data available, avoid problems of missing data and any misinterpretation for this period.

provided the company with rather high profitability with 49.1 per cent of rate of return on sales revenues (ROS). Therefore, the sharp decline in ROS from 49.1 per cent in 1988 to 15.5 per cent in 1989 may be attributed to the split of USAS into two separate firms and its impact on the company's financial structure.

After its privatisation, USAS's gross profit earned on its sales (i.e. ROS) started to rise from 15.5 per cent in 1990 to 48.6 per cent in 1992 and then, to its highest level since privatisation, 69 per cent in 1994. The figure for 1995 declined to 48.9 per cent. That anticipates an average 37.5 per cent profitability in the post-privatisation period of 1989-1995 (see Table 7.3).

Table 7.3: Changes in Performance Indicators of USAS, 1982-1995

Performance Measure	**1982**	**1983**	**1984**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
Profitability Indicators											
ROS (%)	94.2	81.6	48.3	49.1	15.5	15.5	22.4	48.6	42.7	69.0	48.9
ROE (%)	98.5	100.6	85.5	53.2	n.a.	52.9	88.8	130.3	170.8	140.1	155.6
ROA (%)	116.2	100.9	115.5	n.a.	n.a.	31.5	43.5	77.6	69.4	84.9	76.2
Productivity Indicators											
SALEFF ('000TL)[1]	n.a.	n.a.	19	23	23	31	54	71	95	110	82
OUTEMP (meals)[2]	n.a.	n.a.	n.a.	n.a.	n.a.	4,743	4,279	6,125	9,849	10,770	12,402
Other Indicators											
Pre-Tax Profits ($m)[3]	7.7	8.6	10.0	12.4	4.5	6.3	9.4	29.8	30.4	55.7	36.8
Gross Sales ($m)[3]	14.7	17.9	20.7	25.3	29.0	40.6	42.2	61.3	71.1	80.8	75.2

Note: (1) Total Sales (at constant prices)/No. of employees; (2) Total number of meals served/Total number of employees; (3) All Turkish Lira (TL) values were converted into US$ on the basis of the Central Bank's average exchange rate at the end of each year. All nominal figures such as gross value added and sales were converted to constant prices by deflating them with WPI based on 1981 prices (1981=100). Data covering 1990-95 look more accurate and similar to those used in international accounting because of the ISE's requirements in the accounting procedures of the stock exchange market; n.a.= data is not available.
Source: The table is tabulated from data given in *Morgan Bank* (1986); *The Yearbook of ISE* (various issues between 1993-96) and *USAS: Annual Company Reports*.

The other measures for financial performance (i.e. ROE which indicates the profits earned on the company's total equities, and ROA which demonstrates the rate of return on assets) followed the same line with profit-to-sale ratio. A rate of 52.9 per cent of ROE in 1990 increased steadily and reached 170.8 per cent in 1993, and then it

declined slightly to 155.6 per cent in 1995. In terms of the rate of return on assets, USAS brought up the ratio to 84.9 per cent in 1994 from 31.5 per cent in 1990. As the figures in Table 7.3 demonstrate, ROA decreased slightly in 1993 and 1995 compared to the previous year's figures. The average figures for the post-privatisation also show an improvement in terms of return on equity and assets ratios. For example, Table 7.4 shows that there is an average of 123 and 63.8 per cent ROE and ROA respectively in the 1989-95 period.

A review of the figures presented in Table 7.3 and 7.4 for USAS indicates that there have also been substantial improvements in labour productivity after the privatisation. Table 7.3 shows that since the privatisation, the number of meals served per employee (OUTEMP) increased significantly each year until 1995 except in 1991. For instance, the number of meals served per employee increased to 12,402 in 1995 from 4,743 in 1990. That represents an output growth of 160 per cent in the number of meals served per employee. As a consequence of the strike in THY in 1991, OUTEMP fell from 4,743 in 1990 to 4,279 in 1991 which represents about a 10 per cent decline, but it increased again to 6,125 meals in 1992.

Table 7.4: Average Profitability and Productivity Indicators of USAS, 1982-1995

Performance Measure	**1982-84**	**1989-91**	**1992-95**	**Post-Priv. 1989-95**
Performance Indicators				
ROS (%)	74.7	17.8	52.3	35.6
ROE (%)	94.9	70.9	149.2	108.9
ROA (%)	110.9	37.5	77.0	57.4
Performance Indicators				
SALEFF ('000TL)[1]	n.a.	36	90	63
OUTEMP (meals)[2]	n.a.	4,511	9,787	7,149

Note: (1) Total Sales (at constant prices)/No. of employees; (2) Total number of meals served/Total number of employees. All nominal figures such as gross value added and sales were converted to constant prices by deflating them with WPI based on 1981 prices (1981=100); n.a.= not available.
Source: See Table 7.3.

The second measure employed for labour productivity which is sales per employee (SALEFF), also recorded a very significant improvement. The figures for total sales per employee with constant prices grew considerably over the seven years following the privatisation. Whilst the share of an employee in total sales was TL19,000 in 1984, and TL23,000 in 1989, USAS's total sales per employee reached TL110,000 in 1994, and then decline in 1995 to TL82,000. Thus, it is possible to argue that privatisation has had a very significant effect on the labour productivity both in terms of the meals served and the sales per employee with constant prices.

Even though the overall performance of USAS following its privatisation so far looks rather satisfactory, there are still some issues which need to be discussed in this chapter. As stated earlier, one of the main objectives of the Turkish privatisation policy was "to increase the quality, quantity and diversity of goods and services" as well as "to increase productivity and efficiency". More specifically, in the case of USAS, it was expected that privatisation would bring this enterprise "up to international standards in its services" with the new technology and know-how of the new owner, SSP, and its "distinct specialization and management superiority" in airport management. It was also planned that opening up the company to market forces would diminish USAS's monopoly position. So, one needs to look at the USAS's case and find out how many of these goals have been achieved so far and to what extent before drawing a more general and acceptable conclusion. Much of the discussion in the following pages is based on qualitative evidence gathered through the interviews conducted and the press reports cited from the Turkish media. Hence, caution may be needed in the absence of hard evidence when issues like quality improvements or competition are discussed.

When asked whether there is any considerable change in the management style of privatised USAS, Mr. Hertel answered with an emphatic "yes". He still remembers the problems and the struggle people were going through in USAS when SSP took over the company seven years ago:

> We admired the people in USAS seven years ago because they were facing enormous problems including the heavy burden of dealing with the bureaucracy. Like any other state enterprise, the decision making process was working very slowly. The sale of USAS to SSP released the chains of bureaucracy soon after privatisation. Naturally, this brought about the flexibility and speed in the decision making process which USAS needed at the time. Besides, the change in ownership largely minimized the political interference (personal interview, September 1995).

Mr. Hertel went on to explain about the great difference between public and private enterprises as he saw it. He believes that decision making is often delayed or takes much longer in the public sector because of the bureaucracy, whereas a private enterprise makes its decisions fairly quickly so that it can respond to the changes in the market in the shortest time possible. And that makes it easier to give services to customers and to ensure customers satisfaction. Mr. Hertel remarks that there have not been many changes in terms of USAS staff since the new management took over the control of the company, but he is very convinced that "the mentality within the company has changed completely". He argues that the training facilities and opportunities which the company provides to its staff, from cooks to managers, has made this transition smoother and easier than expected. Indeed, this point is also verified by TOLEYIS with much appreciation. Trade union representatives confirm that their members have been using the facilities such as language courses and training schemes on a regular basis.

One official in the PA, Ms. Varli, finds the new owner of USAS very successful in terms of improving the image of the company, especially in terms of the quality of goods and services it provides. She accepts that even though much of the equipment

in USAS kitchens was relatively new prior to privatisation, SSP still decided to renew and update all the kitchen equipment in order to increase the standard of its services. But most important of all, she believes that in the early 1990s "SSP set up the rules and standards of a hygienic kitchen in the catering sector for the first time in our country" similar to those in advanced countries (personal interview, September 1995).

This view seems to be shared by almost everyone interviewed. When asked whether there is any difference between the catering services offered by USAS in Turkish airports and the services offered at international airports around the world, Mr. Hertel replied with much confidence that "there is no difference at all". He further emphasised that now USAS is fully integrated into the Gate Gourmet Group and is subject to the same high standards of quality as all Gate Gourmet companies around the world.

Several newspaper articles reported and also Mr. Hertel confirmed that since 1994, USAS like all the other Gate Gourmet companies commits itself to top quality standards and has therefore introduced a special "*Quality Guarantee Certificate and Letter*" as part of total quality package. This policy guarantees on-time performance and the production of high quality meals for its customers. If the the punctuality of the service fails or if the standards are not met, USAS offers compensation to its clients.

As with performance indicators, quality assurance methods can be useful, but may also serve to deceive rather than reveal concerning the standards of good and service experienced. Therefore, since little is known, one should be cautious about the commitments of USAS on quality improvement and service punctuality. The whole issue is perhaps a part of public relations exercise by the company through the media. Quality can be generally described as 'that which gives the customer satisfaction and

quality assurance is about setting up systems that ensure that a service or product consistently achieves customer satisfaction'. Based upon this definition of quality, during the fieldwork, it was not possible to find further evidence or any research conducted to back up and to prove that changes in quality occurred as a result of privatisation as claimed by USAS, PA and others. For instance, a customer satisfaction survey about the goods and services of USAS would have been helpful to show complaints and/or the percentage of dissatisfied customers served by the company as well as to enrich the analysis made in this chapter. However, if one looks at the issue from a positive side, concepts like 'total quality' and 'service punctuality' are relatively new in the Turkish market but once they are established in the airline catering as well as in other sectors of the Turkish economy, elements of a quality orientation may improve the standards of goods and services and better relationships can be built with clients who are more satisfied with the service they have received.

Mr. Hertel reveals that the company is planning to increase the quality, quantity and diversity of its goods and services further in the near future with the assistance of the "remarkable technology and wide experience of Gate Gourmet in the field of catering". He says that:

> Our aim is to keep up the level of performance that we achieved in the past five-six years. One of our primary objectives is to provide the best service with the lowest price possible. That is our slogan to carry out our duties (personal interview, September 1995).

With regard to competition in the sector, the Privatisation Administration dismisses the claims that USAS became a private monopoly after the privatisation. It is argued by Ms. Varli that no statutory right was given to privatised USAS in order to maintain its monopoly position. Furthermore, she explains that prior to its privatisation in 1989, the monopoly position of USAS was eliminated by the PPA. However, Ms. Varli's statement seems to be an ambiguous one because it does not

state exactly how the monopoly position of USAS was eliminated. This study found out during the interviews with other government and PA officials that the government prohibited the entry of a public firm into the airline catering market for ten years. Thus, this did not affect USAS's monopoly power in any significant way, let alone eliminating its monopoly status in a fast growing market as claimed by Ms. Varli.

The PA officials also failed to mention how the monopoly position of USAS has indirectly contributed to the company's profitability and, as a matter of fact, the Turkish treasury has benefited from relatively high profitability of the company since its privatisation in two ways; the first benefit was the collection of corporate taxes, and the second one, according to the sale agreement, USAS will continue to pay 21 per cent of its pre-tax profits to the PA until 1999. Hence, the growing pre-tax profits of USAS (almost six times) since 1989 have generated extra income to the Treasury.

As discussed earlier in this chapter, the stiff competition of airline carriers had an negative impact on airline catering companies. As a consequence of this, airlines had to reduce ticket prices and thus this development naturally forced airlines to reduce their running costs anywhere possible. For most airlines, cutting down the cost of the catering services they offer to their passengers was one of the easier options. USAS, the biggest airline caterer in Turkey, had its share from this negative development. Recently USAS has been under increasing pressure to prepare cheaper menus and/or to bring down its inflight catering prices.

At present, USAS is the main catering company which provides inflight catering services to the major domestic and international airlines at Turkish airports, and it is the only company that gives catering services to THY. That puts USAS into a strong position where it holds the biggest share not only in airline catering and but also in the terminal catering services market in Turkey. It enjoyed its monopoly position for a

long time even after its privatisation because there was no match to its size in the Turkish airline catering sector, but now some steps towards competition in the airline catering services sector in Turkey have been taken. USAS is facing an increasing competition particularly in the domestic charter flights sector from other domestic companies. Since 1992, there are other airline catering firms operating in the market. Some of the domestic airlines such as the privately run Istanbul Airlines, Sancak Air, Sultan Air and Green Air have recently established their own catering units.

Istanbul Airlines, for example, offers its catering facilities to other scheduled domestic and international flights. In particular, the newly established Sancak Air and Istanbul Airlines' catering sections have been seeking their share in the airline catering market. Initially, Sancak Air and Istanbul Airlines set up their catering units to serve their own flights, but today they are also able to cope with the demand of small scale airlines. The shares of the two companies are not significant enough to threaten USAS's market position yet but it looks that if their growth in the market continues they are going to pull USAS into a more competitive market. Shortly after starting to serve with a single unit at Istanbul airport in 1990, Istanbul Airline expanded its operations to Izmir, Antalya and Dalaman airports, and the company recently reached the total capacity of about 40 thousand meals a day during the high season at the same airports.

Furthermore, regardless of their shares in the catering market, these new catering companies sometimes can adopt more aggressive marketing policies such as cutting the prices of catering services by 50 per cent. This growing trend of competition in the sector has now brought down the average price of a meal per person to $3-4 compared to $8-10 in the early 1990s when USAS retained its absolute monopoly in major Turkish airports (*Milliyet*, 26.11.1994). This new and relatively competitive

environment with falling catering prices and increasing number of caterers may put USAS into a difficult position to reconsider its investment and employment policies in order to cut the costs and compete with the prices of other firms.

Based upon the above evidence, it is possible to state that with privatisation, the market power of USAS has not been reduced substantially but the monopoly position of the company, compared to its pre-privatisation, has been weakening slowly. In fact, the question of whether privatisation would end the monopoly of USAS was debated intensely during its privatisation in 1989. Privatised USAS now has competitors which can slash prices by 50 per cent. Moreover, with the opening of new airport terminals, there will be new restaurants and new companies running catering services. Thus, it appears that there will be more companies in the airline and airport catering sector. For example, with the completion of the new terminal building for charter flights at Istanbul Airport, USAS will have a new competitor in terminal catering services besides other existing caterers in inflight catering services.

The management of USAS does not seem to be taking all these developments as a threat as far as USAS's market prospect is concerned. The general manager of USAS, Mr. Hertel, agrees that the developments in the sector will eventually affect his company's business, but he rejects the contention that competition brought by newly established catering firms, may reduce the market share of USAS significantly and hence its economic performance in the coming years ahead. Naturally, when compared to its rivals, USAS has clear competitive advantages in the market because of its modern production facilities and equipment, and long experience in the sector. Mr. Hertel convincingly argues that:

> We are not afraid of competition. I am sure that USAS's well established experience in the airlines catering business will maintain its superiority in terms of the quality of its

> products and services. USAS will continue to be the leader in the market for many more years (personal interview, September 1995).

This answer is acceptable with regard to the domestic airline catering companies. Nevertheless, there is a possibility of new international competitors which USAS may have to face in the Turkish airline catering services sector. Çelebi, a privately owned ground handling company, has plans to set up a joint-venture catering company with a foreign firm (*Ekonomist*, 1.9.1996). When asked how this would affect the policy and market status of USAS, the present view of the USAS management was not clear yet. It needs to be seen how the future prospects for both the market and USAS will change in the rest of the 1990s. It is an assumption based on the fact that the entry to the airline catering services sector is not restricted any longer and the Turkish airline catering sector in line with the airline sector continues to grow in the 1990s, and thus the market position of USAS in the sector may be undermined seriously by the international catering firms, if and when, they decide to enter the Turkish market.

7.6 Conclusion

This chapter has assessed the performance of USAS over a ten year period covering both pre- and post-privatisation era. The analysis has been done in the context of changing circumstances of both global and the Turkish airline carriers industry. Before its privatisation, as reported by the Morgan Report, USAS was offering low quality and high-priced goods and services compared to the ones provided by its domestic rival, Çelebi, and to international standards.

Increasing the quality, quantity and diversity of goods and services was one of the major aims of the Turkish privatisation programme. With the privatisation of USAS, however, it was expected that USAS would be brought 'up to international

standards in its services' with the new technology and know-how owned by SSP, and this process would also diminish its monopoly position by opening up the company to market forces.

The analysis of USAS shows that since its privatisation in 1989, the company has become a very successful private enterprise. The economic efficiency of the company from 1989 to 1995 seems to have improved considerably in terms of the profitability and productivity measures employed for the analysis of the company. Furthermore, the general opinion of public including the management of the company, trade union representatives, PA officials and media is that USAS has improved the quality and diversity of the goods and services given at Turkish airports and has brought them up to international standards. However, much of the evidence supporting these claims is based upon the interview data and press reports which looks weak and arises doubts.

Even though some steps have been taken with regard to competition in the sector, USAS continues to be the main caterer which provides inflight catering services to the major domestic and international airlines at Turkish airports, and it is still the only company that gives catering services to THY. That puts USAS into a position where it holds the biggest share not only in airline catering but also in the terminal catering services market in Turkey. The company enjoyed its monopoly position for a long time even after its privatisation because there was no match to its size in this sector. However, attempts by a number of domestic airlines to establish their own catering units and to offer their facilities to other scheduled and domestic and international flights, look as if the competition in the sector has finally started. Though their total shares in the sector does not significant enough to threaten USAS's market position yet, but they are able to cut the prices of their catering products and

services by 50 per cent with their aggressive marketing policies, and this will presumably pull USAS into an increasingly competitive market.

In summary, if one evaluates the case of USAS in terms of the main objectives of privatisation set by the government (e.g. increasing the quality, quantity and diversity of goods and services provided at the Turkish airports), it looks as if the privatisation of USAS has been a success. The qualitative evidence presented here suggests that since privatisation in 1989, the quality standards and diversity of goods and services in the Turkish airport have improved. The management of USAS pledges that the company will continue to be the leading airline caterer by using the skills and experience of the entire Gate Gourmet network worldwide. USAS aimed to develop products and systems to the benefit of both the customer and the company (personal interviews, 1995-96). However, it remains to be seen what benefits consumers are going to gain from the above pledges as well as from the introduction of competition and gradual elimination of USAS's monopoly power in the sector. It is likely that the competition will bring further improvements and lower prices in the sector.

CHAPTER 8: Assessing the Performance of TELETAS and NETAS

8.0 Introduction

The sale of Teletas in 1988 through a public offer was the first privatisation experience in Turkey. The main aims of the government with the sale of Teletas were to extend ownership and to develop the capital market. Before the sale, PTT's[1] participating shares in Teletas and Netas were transferred to the PPA. Even though the sale of Teletas's 22 per cent shares was realised in 1988, the decision of privatising Netas was delayed until March 1993.

This chapter examines the performance of privatised TELETAS and its major competitor, NETAS[2], between 1986 and 1995. The performance analysis of Teletas will focus on the three years leading up to its privatisation and then its seven years as a private company. Since the privatisation of Netas occurred recently (in 1993), it will be examined whether or not there is "an announcement effect" on Netas's performance. The aim of the chapter is to find out how these two telecommunications equipment manufacturers performed following the privatisation in a market which has been fast changing and growing, and has a duopolistic nature in Turkey.

8.1 An Outlook of the Turkish Telecommunications Market

In order to understand the impact of the privatisation of Teletas and Netas on the telecommunications system in Turkey, on the one hand; and, the impact of this privatisation on the performance of Teletas and Netas within quickly changing

[1] Turkish state-run Post, Telegram and Telephone company.

[2] TELETAS and NETAS denote Telekomünikasyon Endüstri ve Ticaret A.S. and Northern Elektrik Telekomünikasyon A.S. respectively.

circumstances in the telecommunications market on the other hand, one needs to look at the brief evolution and the structure of the Turkish telecommunications system up to date. The close relationship between the PTT, the main pillar of the Turkish telecommunications system, and these two telecommunications equipment firms also needs to be highlighted in this context.

Turkish PTT was the main organisation responsible for supplying telecommunications services in the country as well as postal services until recently. In 1994, Turkish PTT was restructured by dividing the enterprise into two separate entities: postal services and telecommunications services as a first step towards the privatisation of the telecommunications services. Türk Telekomünikasyon A.S. (known as Türk Telekom now) was assigned to carry out telecommunications services in the country (*Intermedya*, 1995). Until 1994, however, the Turkish telecommunications administration was not a regular government department but rather it was operated as a commercially oriented state enterprise since the 1930s.

The development of the telecommunications system in Turkey can be traced back to the early 1880s. Even though the system grew gradually and continuously from the early 1930s, most of the country still did not have a phone service until the mid-1960s.[3] For the expansion of telecommunications service area, Netas was established in 1967 as a joint venture company between the Turkish government and Northern Telecom Limited of Canada (Nortel). The aim was to supply the PTT locally produced telecommunications equipment. PTT also established a research and development organisation, ARLA, at around the same time. Soon the first locally manufactured microwave system was put into service after ARLA obtained a license from Bell Telephone Manufacturing, the Belgian ITT company. The system expanded

[3] I have benefited from the study of Eroglu (1992) in this section.

rapidly after this and today telephone service is provided throughout Turkey. In 1984, the system was further improved to provide telex, teletex, and data services normally found in telecommunication systems of more developed countries.

PTT also began to convert the electromechanical technology of the 1960s to the digital technology of the 1980s in 1982. Even though the joint venture with the Canadian company, Netas, was still in existence and had a digital system in service, PTT decided that some competition would improve quality and reduce prices. As a result, it asked for competitive bids for providing new equipment. In search of an appropriate company that could provide digital switching, the PTT administration conducted an industrial survey of other companies such as AT&T, Ericsson, Fujitsu, GTE, ITT, NEC and Siemens. At the end, a new system started to be manufactured at PTT's newly organised division named Teletas, formerly known as ARLA.

Netas emerged as the largest indigenous producer of telecommunications equipment in Turkey and the Middle East in the late 1980s. Besides Netas, Teletas became the second largest telecom equipment manufacturer in Turkey in 1985 after establishing a joint venture with Belgium's Bell Telephone company. Two years later, in 1987, Siemens also entered the Turkish telecommunications market when it was awarded an initial contract to supply 100,000 digital switch lines (Eroglu, 1992, p.21).

In Turkey, the telephone service at present serves approximately 65 per cent of the households but large sections of rural areas are still in need of some additional service. The level of the telephone service is lower than that in developed countries. For instance, the telephone service reached 91 per cent of the households in the USA in 1983 while the rate was around 80 per cent in the UK before BT's privatisation in 1984 (Hills, 1989; Eroglu, 1992).

The Turkish PTT has been making significant progress to accomplish the organisation's multiple objectives such as obtaining a high technological level, a near universal service level, and meeting the needs of the business community. The main aim is to advance the telecommunications system in the country beyond the level of most developing countries in the 1980s and 1990s with the limited resources available. Over the last decade, almost all the villages in the country received telephone facilities. The total number of villages in Turkey is slightly above 40,000 and most of them have telephone facilities compared to 8,431 villages in 1982. Much work has to be done to improve the telephone services further because only 3,000 of these villages have a telephone exchange system. The number of telephone subscribers has also increased an average of 20 per cent per annum during the period of 1982 to 1993. The most successful years for PTT so far have been 1987 and 1988, when the number of telephone subscribers increased 33 per cent per annum. The number of telephone subscribers reached over 11 million in 1993. The government's target for 1994 was 12.5 million telephone subscribers and 13.4 million telephone exchange line capacity (Eroglu, 1992, p.62; SIS, 1996; *Dünya*, 4.5.1995).

Improving the telecommunications infrastructure is extremely expensive and it is simply beyond the economic capability of some countries. It is estimated that there is a cost of about $1,000 per new line in the 1990s. According to the UN estimates, simply improving all of the world's telecommunications infrastructure to the level of one phone for every ten people would involve investments of around $300 billion (Beardsley and Patsalos-Fox, 1995, p.4). That implies a higher growth rate in 1990s than 8 per cent in 1980s in the global telecommunications sector. In contrast to the growth figures of global telecommunications market, the average growth rate in the Turkish telecommunications sector was much higher in the 1980s, around 15 per cent;

while this rate has been only around 3-5 per cent per year in the 1990s (PA, 1988a, p.3; *Intermedya Ekonomi*, 1.5.1994).

The level of telephone line density in Turkey has risen steadily over the years especially in the 1980s and 1990s. While there was a density of 2.9 lines per 100 people in 1980, and 9.2 lines in 1987, the rate of telephone density in Turkey increased notably and reached 21 lines per 100 people in 1993.[4] These figures are obviously well behind most of Western European and other developed countries. The line density per 100 inhabitants, for example, is 92 lines in Switzerland, 76 lines in the USA, 61 lines in France, 49 lines in the UK. But Turkish telephone penetration rate is well ahead of Argentina with 14 lines, Mexico with 12 lines and Egypt with 5 lines per 100 people (PA, 1988a, p.3; *Intermedya Ekonomi*, 1.5.1994; *Dünya*, 24.10.1994; Rey, 1995, p.26).

Furthermore, the degree of automation and digitalisation also increased from less than 80 per cent in 1980 to 99 per cent in 1994. Some telecommunications system analysts argue that Turkey has the third most advanced digital telephone exchange system in Europe after the UK and France. One expert I spoke to stressed that:

> ... the Turkish telecommunications sector almost reached the level of that of developed countries' technology standards after the massive investments made during the 1980s; but due to the cuts and discontinuity in new investments in the telecommunications sector in the following years, the technological gap between those developed countries and Turkey could not be closed by the Turkish telecommunications sector (personal interview, September 1995).

It is a fact that Turkey has already established a modern telecommunications system and it has converted most of its electromechanical technology into digital

[4] It is estimated that the total capacity of exchange lines is 14 million while the number of subscribers is around 13.1 million in 1995. That means that the line density in Turkey is now around 22 lines per 100 people excluding 370 thousand mobile telephone subscribers (which is 0.6% line density in mobile phones) (*Dünya*, 4.5.1995)

technology during the 1980s. Turkey is just about to launch its second telecommunications satellite and has been expanding its paging, cellular systems and mobile telephone network in the 1990s.

Moreover, it is essential to bear in mind that Teletas and Netas made a significant contribution to the work done by the Turkish PTT as major telecommunications equipment suppliers. This role also helped them to grow faster and become more prosperous in the 1980s. While the number of digital exchange lines delivered to PTT by Teletas amounted to 2.8 million, which represents 20 per cent of the total line capacity in Turkey, Netas delivered to PTT 9.5 million lines of switching equipment which is approximately 65 per cent of the total line capacity in Turkey and produced more than 6 million telephone sets (Teletas, 1994; Netas, 1995). But discontinuity, and ups and downs in the investment policy of PTT due to economic hindrances have made it very difficult for Teletas and Netas to keep up the high growth rate in the first part of the 1990s.

The world has entered a new era called the 'information age', as the 21st century approaches. In this era, the new key for success for individuals, corporations and societies is to have high communication technology. The competitiveness in the new world order depends on the availability of advanced communications technologies. The present task of Turkey and Türk Telekom, therefore, is to keep on raising the quality of its telecommunications network to the level of the developed countries. The newly established Türk Telecom is planning to produce an additional one million digital lines per year in the next five years as well as expanding the level and diversity of its services. It looks that the business partnership between Teletas, Netas and Türk Telekom will continue in the next decade in order to accomplish the tasks mentioned above.

8.2 Privatisation of Teletas and Netas

In 1983, Teletas was converted into a joint stock company from a research laboratory of the PTT. Bell Telephone Manufacturing Company, one of the major subsidiaries of the ALCATEL Group of Companies (ITT at that time), purchased 39 per cent of the Teletas shares, in accordance with a framework license agreement signed in 1984, and became a shareholder to Teletas at the beginning of 1985 (Teletas, 1994).

In the mid-1980s, before its privatisation, Teletas was producing radio-link systems and teleprinters. Plans to produce analogue and digital exchange systems were also underway. The main customer of Teletas was the PTT. Teletas was providing over 90 per cent of PTT's telephone and telegram multiplex systems in 1985. The Turkish Army, the Turkish Railways and the Public Security Directorate were also among the customers of Teletas. The company was able to export a small percentage of its products too. PTT's second holding company, Netas, was engaged in the production of analogue and digital exchange systems, private switching equipment and telephone sets in the mid-1980s. Netas's main customer was also the Turkish PTT alongside small exports made to the Middle Eastern countries.

The Morgan Bank Report (1986) classified both Teletas and Netas as 'entirely saleable' and thus, first priority was given for their privatisation. According to the Report, both enterprises were 'attractive candidates' for the sale of part or all of PTT's holding to private investors (p.54). The Report described Teletas and Netas as follows:

> [They] appear to be particularly attractive candidates for the gradual sale of shares onto the capital market (1986, p.56),

and it suggested that:

> ... because of the monopsony situation of the telecommunications market in Turkey, PTT being the major buyer, and TELETAS and NETAS being the major suppliers, we recommend that PTT's percentage participation in the capital of TELETAS and NETAS be similar after the sale of PTT's holding, if PTT retains any holding at all (1986, p.72).

On February 1988, following an extensive advertisement campaign, the first implementation of the large-scale privatisation took place with the sale of 22 per cent of Teletas's shares to the public with the aim of extending ownership and development of the capital market. It is important to note here whether the academic argument had any influence on the set aims of Teletas privatisation. Most scholars believe that the existence of a developed stock market is a prerequisite for privatisation and financial modernisation (Aylen, 1987; Murphy, 1988). Their reasoning is that if an active market already exists, it may rapidly become a vehicle for conducting the sale of SEEs which will in turn strengthen the market itself. The presence of a stock market is also evidence that a country has the necessary conditions for private business to flourish. When asked why Teletas was chosen as the first privatisation case, one official who I interviewed in the Privatisation Administration said that:

> ... because Teletas had a relatively high profitability and it embodied modern technology which has made the telecommunications industry look as a very promising candidate for privatisation (personal interview, September 1996).

Furthermore, the same source also added that:

> Teletas was not only a profitable enterprise, but it was also run by very successful management. Hence, contrary to other public enterprises it did not require rehabilitation before it was privatised (personal interview, September 1995).

Teletas was a mixed corporation, with 40 per cent of its shares being owned by PTT, 39 per cent by Bell Company and 21 per cent by a number of shareholders in Turkey. After the decision to privatise the company in 1986, all of PTT's shares were transferred to the PPA in 1987. The sale of Teletas's 22 per cent shares generated $13 million. The shares of the company were sold to public and to the employees of

Teletas through 4,822 bank branch offices and intermediary financial institutions. At the end of the sales, 41,695 people became shareholders in Teletas (PA, 1995b; Çelebi, 1995).

However, with the privatisation of the company, the Bell Company became the largest shareholder with its 39 per cent of shares. So, a control mechanism was introduced to prevent this foreign firm from controlling the management of Teletas. Through this mechanism the PPA was to keep its control on the management of the company with the right to veto, which entailed the preservation of a 'golden share' until its 18 per cent shares were reduced below 3 per cent. It was expected that this mechanism would also protect the rights of the small shareholders and stop a future transfer of the shares of Bell Company and other local shares which might have negative effects on government policies.

The privatisation of Teletas, when evaluated in terms of both the number of the people involved and the quick sale of the shares, appears to be a successful operation at first sight. However, the following important particulars of the case should also be highlighted. First of all, a few months after the sale, the Teletas shares began to lose significant value in the ISE, declining from their original sale value of TL5000 to TL2700 at current prices. However, it was reported that most of the shareholders did not wish to sell their shares and it is believed that most of them have kept their Teletas shares up to date. This is claimed to be an indication that the shareholders of Teletas have viewed their share purchases as a long term investment (Ilkin, 1994, p.83).

Secondly, the results of this first large-scale privatisation revealed the shallowness of the capital market to handle a large-scale transfer operation because any increase in the supply of the shares had a depressive effect on the prices of the shares due to the inadequate demand. The experience of Teletas privatisation, to some

extent, also showed the ineffectiveness of privatisation in the development of the capital market in a developing country context. Thus, it would not be wrong to say that the aim of the privatisation of Teletas concerning the development of the capital market could not be achieved.

Besides, the third point is that since one of the major concerns of the government has been the elimination of the extra burden caused by the inefficient and unprofitable state economic enterprises on government budget, choosing a profitable company for privatisation appeared to be a further paradox. But one can argue that it was done on purpose-to make privatisation seem attractive.

The privatisation experience with Teletas made the authorities realise the immaturity of the capital market in handling large-scale privatisation programmes. Soon it became evident that the government would push through privatisation by selling shares not on the open market but to big capital groups directly, such as the sale of five cement plants to SCF and the sale of USAS to SSP as discussed in the preceding chapters.

The privatisation of Teletas was completed five years after its initial privatisation. In 1993, ALCATEL Holding BV purchased approximately 18 per cent of the shares held by the PPA, and the shares held by STFA (7%) and Ray Sigorta (1%). Consequently, the ALCATEL Group has become a major shareholder of Teletas.[5] At present, the company continues its operations in Turkey under the name of ALCATEL TELETAS (Teletas, 1994, p.3).

However, the Privatisation Administration decided to sell 20 per cent of NETAS shares to the company's second major shareholder, Northern Telecom (Nortel), in

[5] In 1995, the shareholders of ALCATEL TELETAS are as follows: ALCATEL Bell (39%) and ALCATEL Holding BV (26%), and others (35%).

March 1993. With this block sale, Nortel became the largest shareholder by increasing its share from 31 per cent to 51 per cent and took control of Netas completely. In the same month, the PA also sold 7.5 per cent of the 29 per cent remaining shares to the public and the shares of Netas were purchased by 4,897 people. The PA generated $27.8 million from the block sale of 20 per cent of its shares to Nortel while the revenues of the public offer was $8.7 million. Currently, both Teletas and Netas are fully privatised telecommunications equipment companies. Officials in the PA expressed the interest of the government in selling the remaining shares of Netas, possibly through public offering, in the near future (personal interview, September 1996).

8.3 Performance Analysis of Teletas and Netas

In this section, the performance of Teletas and Netas is examined over a ten-year period starting with 1986. The aim is to centre the analysis on the claim that privatisation would improve company performance. The performance of Teletas will be analyzed in the three years leading up to its privatisation and then its seven years as a private company. It was decided by the researcher that because the privatisation of Netas is so recent, privatised in March 1993, that its performance before and after privatisation cannot be meaningfully compared. However, it is still possible to study whether or not there has been an announcement effect on its performance and whether there has been a substantial "cleaning-up" of the company to prepare it for sale under the supervision of the Privatisation Administration since 1987.

Comparison between Teletas and Netas, nevertheless, will be done from a cross-company perspective. Both companies share very similar economic, historical and institutional characteristics as mentioned earlier in this chapter. Netas also provides

an interesting comparison with Teletas because its size is comparable and it has undergone more or less the same major institutional and economic restructuring as well as operating in identical market circumstances during the period of observation. To get a better understanding of the performance of these two privatised enterprises during the observation period of 1986-1995, one needs to analyse the performance of the Turkish economy over the same period.

Economic policy in Turkey was designed by the successive MP governments until 1991 and then by the coalition governments led by the centre-right TPP. In the first half of the 1980s, Turkey followed a far reaching programme of stabilization combined with structural change as discussed in chapter three. Despite some achievement of the programme such as an impressive growth in export earnings, the achievements of the stabilization-cum-structural adjustment programme of the early 1980s have been overshadowed by the persistent high inflation since 1987, whose main cause was a large public sector deficit and the poor performance of the public enterprises. However, during the 1985-92 period, in spite of large internal imbalances, Turkey was able to grow at an average rate of 5 per cent per year (Treasury, 1996).

In particular, the public sector deficit in Turkey rose substantially after 1987 causing the frequent emergence of macroeconomic imbalances. The year of 1994 is remembered as the worst ever crisis in the history of the country. High public sector deficits led to a catastrophic financial crisis in the first quarter of the year. The economy nose-dived. The inflation rate reached 150 per cent in the first quarter of 1994, the Turkish Lira plummeted against the dollar and industrial output shrank by 12 per cent.

A stabilization programme was immediately enforced in April 1994. The programme emphasised cuts in public expenditure and reduction in the budget deficit

as well as implementing a large scale privatisation programme. Due to the government's spending cuts, investment in the public sector declined by 35 per cent. Industrial production fell 5 per cent while the manufacturing output was down by a further 8 per cent in 1994. A reasonable success was achieved in the public finance deficit. PSBR to GNP ratio came down to 8 per cent at the end of 1994 from 12.1 per cent previously (*The Banker*, 1994; TÜSIAD, 1995).

Against this background, however, the Turkish telecommunications sector recorded very impressive progress especially during the 1980s. The government wanted to improve the infrastructure of the telecommunications sector in the country. So, large investments in this sector were made. The outcome of this policy was an average growth rate of around 15 per cent per year in the telecommunications sector during the 1980s, while the rate has been only around 3-5 per cent per year in the 1990s so far (PA, 1988a, p.3; *Intermedya Ekonomi*, 1.5.1994). Moreover, this intensive investment policy also resulted in a large increase in the number of telephone lines available. The number of telephone subscribers reached 5.8 million in 1990, and then 12.3 million in 1994 from 1.1 million telephone subscribers in 1980, (SIS, 1996).

Teletas and Netas have had a significant role in the course of this advancement as leading telecommunications equipment manufacturers, and their businesses have been also instantly altered by the economic developments and changes in the Turkish economy in general and in the telecommunications sector in particular, regardless of being positive or negative. Thus, when one evaluates the results of the analysis made here, one must give prime consideration to the various erosive effects on the economic growth of the sector and these establishments, such as inflation and fairly regular setbacks in public sector investments. Furthermore, some of the results of the

financial and productivity performance analysis, to some extent, can be attributed to the changes that occurred following privatisation. It appears that two of these very important changes are; first, an exogenous macroeconomic impact following the Turkish downward economic trend after 1987. Second, a probably less obvious endogenous impact of investment constraints of the PTT in a monopsony situation in the Turkish telecommunications sector, PTT being the major buyer, and Teletas and Netas being the major suppliers.

8.3.1 Financial Performance

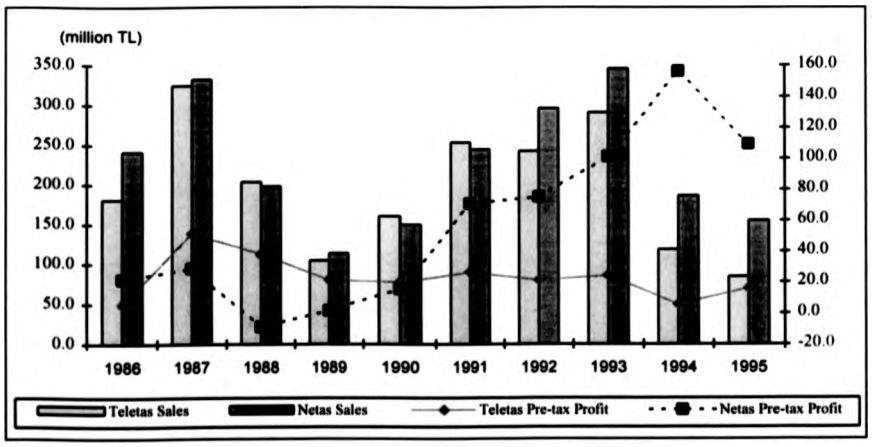
Figure 8.1 below shows sales revenues and pre-tax profit of Teletas and Netas at constant prices between 1986-95. The total sales revenues of both companies recorded a significant increase in 1987 compared to the previous year. Teletas's sales figures at constant prices were TL324.7 million while its counterpart Netas's were TL332.7 million in 1987. In parallel to these figures, the pre-tax profit of these companies also rose TL51.4 and TL28.8 million respectively in the same year. This high growth rate in sales, especially for Teletas, was partly related to the eager investment policy of the Turkish PTT which resulted in a huge expansion in the telecommunications sector; and, partly, it was related to the push up in government spending due to the general election held at the end of 1987. However, as a result of intensive investments by the PTT, the number of telephone subscribers increased about 1.4 million in a single year and reached 3.7 million in 1987.

In fact, the year 1987 in Turkey was a turning point as far as the telecommunications sector was concerned. As Mr. Yenel, General Manager of Teletas, explains, after 1987 the sector went into a declining market position and did not recover fully for some years. He points out that:

> ... the steady improvement and growth of the economy during 1982-87 in a stable macroeconomic environment ended, and the declining trend of the economy dominated after 1988. Wild swings in the economy started to make life very difficult for everyone (personal interview, January 1996).

The sales and profit of both companies started to decline following the boom of 1987, and continued declining until 1991. In between, the frequent crises, whether political or economic, kept on determining the performance of these two enterprises. For example, in 1988, cuts in PTT's investment programme forced Teletas to reduce its average production by 39 per cent and 11 per cent in the following year. Similar but less severe measures were also taken in Netas (Teletas, 1995; ISE, 1995). The impact of these changes was an immediate sharp decline in sales and profit figures of Teletas and Netas. Sales of Teletas dropped to TL104.7 million at constant prices while profit before tax amounted only TL21.3 million in 1989. The sales and profit of Netas at constant prices in 1989 were TL114 and TL1.7 million respectively.

Figure 8.1: Sales and Profit of Teletas and Netas at constant prices



Note: Sales and pre-tax profit figures are converted to 1981 constant prices by using WPI.
Source: Researcher's own tabulation from data given in the ICI, *Turkey's 500 Large Industrial Establishments*, various issues; SIS (1996); ISE, *Yearbook of Companies*, various years; Annual Reports of Teletas and Netas, 1994 and 1995.

After 1989, the sales figures started to improve slowly, as can be seen in Figure 8.1. This can be attributed to two main reasons. First, the PTT increased its telecommunications investment once again, and thus demand for the products of Teletas and Netas also started to increase in Turkey. In 1991, the number of telephone subscribers, for instance, reached 8.1 million by adding more than 1.3 million new lines to the national exchange system compared to the previous year. This represented a 70 per cent rise in PTT investments compared to the 1990 investment figures. Second, both firms started to turn to exports and to the private sector in order to avoid dramatic falls in demand and real output caused by any public sector spending cut.

Concerning exports, for example, it is observed that both Teletas and Netas made important progress in their export revenues since 1990 as compared to the insignificant amount generated in the late 1980s. The total exports of Teletas were only $0.6 million between 1986-87, whilst Netas's total exports were $2.9 million between 1986-88. In the early 1990s, the exports of these firms increased significantly and they are now regarded as successful exporters in a highly competitive telecommunications field. The total exports of Teletas and Netas were worth $48.6 million and $115.5 million respectively in the period of 1992-95. The Annual Reports and Accounts of the two enterprises show that around 20-25 per cent of their revenues were generated from exports in 1994, and presently both enterprises are planning to increase the share of exports in their total sales revenues by promoting their products further in the international markets.

It looks as if both companies have made remarkable achievements in international markets in recent years by broadening their customer base in several countries as well as making important investments to develop appropriate products for those countries and to meet international standards. Today Teletas and Netas claim to

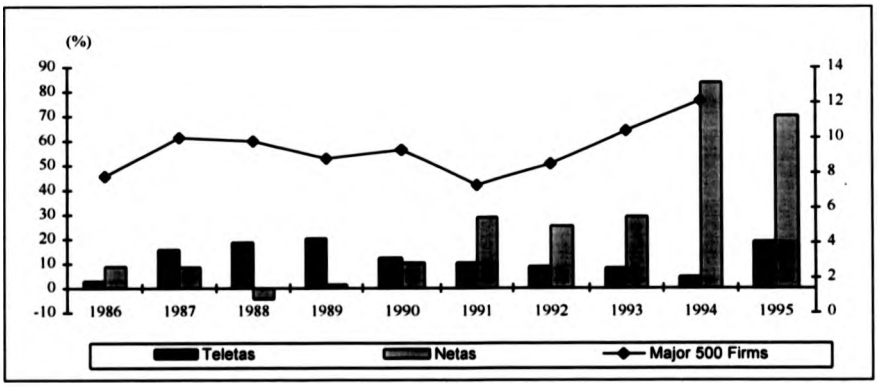
offer 'turn key' solutions in the telecommunications sector at home and abroad. Hence, it can be suggested that efforts to diversify product, customer and market possibly helped Teletas and Netas to improve their sales figures in the first half of the 1990s except in 1994 when the major economic crisis occurred.

Product and market diversification has also continued in the Turkish domestic market. One clear illustration of this new strategy is mobile telecommunication. Mobile telecommunication is fast becoming an essential tool for business as well as for the mass consumer market of personal communication in Turkey. It looks as if Netas has been able to take advantage of this newly evolving mobile communication system (GSM) in the Turkish market. The annual report of Netas states that "campaigns and effective distribution channels have resulted in remarkable sales figures" but it does not state what the percentage of mobile handsets is in its total sales revenues (ISE, 1995, p.738). Teletas Annual Report states that the company is currently studying the mobile communication system and hopes to exploit the new opportunities in the market.

Nonetheless, before the 1994 economic crisis, sales revenues of Teletas at constant prices reached TL291 million while its profit before tax was only TL24 million in 1993. For Netas, figures looked even more encouraging in 1993. Its total sales at constant prices for the year reached TL345.6 million while its earnings before tax amounted to TL101 million. In 1994, both companies had to face an agonizing decline in their sales and profits as a result of the 1994 economic crisis and its subsequent consequences. In particular, Teletas closed the year with serious balance sheet changes. Its sales revenues at constant prices dropped to TL118.8 million whilst the pre-tax profit only reached to TL5.6 million in 1994.

The price of goods and services produced by Teletas and Netas has also had a vital role in the performance of these two companies. It is stated by the management of Teletas that until 1988, Teletas was part of the PTT, therefore, instead of a competitive pricing policy, a monopolistic relationship between the PTT and Teletas was evident. At present, Teletas management says that the price of the company's goods are determined by competition in the sector. Thus, the PTT now pursues a much more competitive bidding policy compared to the pre-privatisation period, which is seemingly an important factor on the financial performance of Teletas following the privatisation.

Figure 8.2: Sales Profitability of Teletas and Netas (%), 1986-1995



Note: Sales profitability shows pre-tax profit-to-sales ratio (ROS).
Source: Researcher's own tabulation. See Figure 8.1

The profitability performance of Teletas shows an upward trend until the end of 1989, the year after privatisation. Figure 8.2 shows a continuous trend of profitability for both Teletas and Netas over ten years. Table 8.1 and 8.2 provide additional data for the profitability (profit-to-sales) ratios of Teletas. The profitability of Teletas increased from 3 per cent in 1986 to 20.3 per cent in 1989. Thereafter it started to decline gradually and became 8.3 per cent in 1993. The lowest profitability rate since

1986, 4.7 per cent, was recorded in 1994 before reaching 19.1 per cent in 1995. Besides the declining profitability rate, Teletas also found itself in a very serious financial crisis in 1994 when the company's debts to the banks reached a very serious peak because the PTT simply could not pay its debts to the company as a result of the 5 April 1994 austerity measures. The management of Teletas realised that the company could no longer sustain its position, and therefore the official receivers were called in to reach an agreement with the banks on a payment plan.

Even though the problem of a near bankruptcy situation was resolved fairly quickly, the crisis of 1994 forced Teletas to reconsider its position and future direction. Mr. Yenel recalls the 1994-95 period as "the period of corporate restructuring" to redesign all the major policies of the corporation. Furthermore, he explains that:

> In this period, the company underwent a serious financial and organisational restructuring. The size of workforce had to be cut significantly, and our product portfolio was also reorganised, the company no longer engages in the production of some economically unprofitable products (personal interview, January 1996).

Mr. Yenel goes on clarifying the matter:

> As part of the corporate restructuring, the company's business was reorganised in a number of areas. Firstly, Teletas is now targeting products and services towards the needs of niche, lucrative markets such as mobile telephone systems. Secondly, the company is coordinating its marketing strategy both at home and abroad, and finally, the company has launched the introduction and application of total quality management[6] (personal interview, January 1996)

It is quite likely that, in terms of microeconomic planning, these measures, as a part of the company's new strategy, will help to increase operational efficiency and consequently, operating margins. But without improvement in trading conditions and improvement towards economic stability, Mr. Yenel underlines that the above

[6] Conformance of the company quality system to ICI 9001 quality standards were already verified in 1994 (Teletas, 1994, p.8).

corporate planning and restructuring may not mean much, and any firm may find itself completely unprepared to meet the challenges in the new economic and trading environment.

He argues that the economic policies pursued by the government are often inconsistent. This inconsistency, he claims, affects all businesses in the economy to some extent, but it affects Teletas more since it has tighter economic relations with the PTT as one of the major telecommunications equipment suppliers. Consequently, "companies operating in Turkey have to forget many of the conventional rules" says Ms. Hatiboglu, Finance Manager of Teletas. She describes this affair as follows:

> You just cannot make projections in a country which experiences frequent crisis. Everything is based on guesses, thus there is no point on making three or six-month planning. You may have a growth of plus 15 per cent one quarter and minus 10 per cent the next. There are times when demand drops off completely, and a year or six months later the production line works flat out and it cannot keep up with demand (personal interview, September 1995).

At first sight, this statement may seem to be exaggerated but the impression gathered during the fieldwork for this study was that others tend to support the above view. Another executive, for instance, complains about the role of the public sector in the frequent crisis. He thinks that "the real problem is the public sector". Furthermore, he underlines the leadership role played by the government. He blames the government because, he states, "the government is very backward in leadership, motivation and resources" (personal interview, September 1995). This point was echoed by the General Manager of Teletas, Mr. Yenel. He confirms that during the 1994 turmoil:

> We [Teletas] had very serious difficulties when all PTT investments were cancelled overnight. As a result we are now increasingly turning to exports and to the private sector (personal interview, January 1996).

He thinks that the government is directly responsible for some avoidable problems affecting his company's business. The wish of returning to more buoyant conditions in the economy, however, was often echoed by the other interviewees across the economy in the course of this study. Most of them look forward to a period of improving economic stability in the economy which will be in turn beneficial for all concerned.

Analysis of other partial indicators of enterprise performance, such as the rate of return on equities and assets (ROE and ROA), do not present a conclusive picture. Over the years, before and after the privatisation of the company, the average rate of ROE has been around 60 per cent while the average rate of ROA has remained around 14 per cent (see Table 8.2). It is therefore not difficult to conclude that the rate of return on equities and assets remained more or less at the same level during the observation period.

The figures for the rate of ROE and ROA, however, appeared to be consistent with the rest of the economy. The yearly regular surveys[7] carried out by the Istanbul Chamber of Industry (ICI), for example, show a similar trend among the 500 large firms in Turkey. Among the 500 firms (showing a profit), the average rate of ROE per annum was 61.2 per cent between 1988-94 while among the private sector firms the rate was 66.2 per cent per annum in the same period. The same ICI surveys also reveal that there have been erosions in ROE in companies in both the public and the private sector since 1988 even though the rate started to pick up again in the 1993-94 period.

[7] *Turkey's 500 Large Industrial Establishments*, published annually by the Istanbul Chamber of Industry .

Moreover, the ICI annual surveys indicate that among the major 500 companies (showing a profit), the average rate of ROA was 14.7 per cent per year in 1988-94, while the rate among private firms was again slightly higher (16.3%) for the same period. It is therefore possible to view the performance of Teletas in terms of the rate of ROE and ROA as normal, compared to the other private sector firms cited in the ICI survey.

However, the profitability performance of Netas looks more optimistic compared to that of Teletas. The profitability ratio of Netas shows a downward trend which started in 1986 and ended in 1988. Netas's profit-to-sales ratio in 1986 was 8.9 per cent and then it started to decline steadily and became -4.4 per cent in 1988. Later, in 1989, the rate of profitability slowly increased to 1.5 per cent. Thereafter the profitability of the Netas began to improve significantly and steadily. The rate of profitability was 10.4 per cent in 1990 which was further improved (29.2%) in 1993. The following two years witnessed the highest rates of profitability so far with 83.8 and 70.3 per cent in 1994 and 1995 respectively (see Table 8.1 and Figure 8.2).

Table 8.1: Changes in Performance Indicators of Teletas and Netas, 1986-1995

Company	Performance Measure	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
TELETAS	*Profitability Indicators*										
	ROS (%)	3.0	15.8	18.7	20.3	12.4	10.4	8.9	8.3	4.7	19.1
	ROE (%)	14.9	118.7	80.2	72.9	68.5	93.4	55.2	76.2	27.3	54.5
	ROA (%)	2.6	19.4	24.1	18.9	11.7	13.3	9.6	7.1	6.0	21.1
	Productivity Indicators										
	GVA (000TL)[1]	52	76	52	52	41	59	62	58	3	47
	SALEFF (000TL)[2]	106	172	97	71	93	138	133	177	99	105
NETAS	*Profitability Indicators*										
	ROS (%)	8.9	8.6	-4.4	1.5	10.4	28.9	25.4	29.2	83.8	70.3
	ROE (%)	151.3	187.9	-60.6	13.1	79.9	416.0	316.8	334.2	239.6	89.3
	ROA (%)	12.2	13.7	-7.1	2.5	14.5	42.9	35.7	30.2	55.9	52.6
	Productivity Indicators										
	GVA (000TL)[1]	26	29	24	26	37	80	82	101	11	53
	SALEFF (000TL)[2]	81	103	77	64	86	141	156	177	111	104

Note: (1) Gross Value Added/No. of employees; (2) Total Sales/No. of employees. All nominal figures such as GVA and sales are converted to 1981 constant prices by deflating them with WPI based on 1981 prices (1981=100).

Source: The table was tabulated from data given in the ICI, *Turkey's 500 Large Industrial Establishments*, various issues; ISE, *Yearbook of Companies*, various years; Annual Reports of Teletas and Netas, 1994 and 1995; SIS (1996).

Two questions need to be asked here; first, whether or not one can relate the upward trend in Netas's profitability which started in 1989 to the "announcement effect" on the performance of the company, or, more specifically, as it occurs in most privatisations, to the "cleaning-up" process to prepare Netas for sale? Secondly, to what extent, can the impressive improvements in the rates of profitability in 1994 and 1995 be attributed to the privatisation? Neither any particular explanation or a public statement is made by the company, nor is there any specific reference to address the above issues in the documents and reports examined. But in the view of the researcher, the share of other income such as interest and foreign exchange gains, has been increasing its importance in the total income of Netas over a number of years as it has been the case in other sectors throughout the economy. The company report of Netas, for instance, shows that the total sales for 1995 is TL7,384[8] billion at current prices. Netas's earnings before tax amounted to TL5,194 billion which was helped by TL4,351 billion, at current prices, of other income from interest earnings and foreign exchange gains. These figures give a profitability rate of 70.3 per cent, which is slightly lower than the profitability rate of 1994. Thus, one explanation for the exceptionally high profitability rate of Netas may be related to the income gained from other operations of the company.

Similarly, the rate of return on equities and assets between 1986 and 1989 was in decline but it started to increase again in 1990. The average ROE between 1989-91 was 169.7 per cent, while the ratio reached 245 per cent during the period of 1992-95. The average rate of ROA for the period of 1989-91 and 1992-95 are 20 and 43.6 per cent respectively.

[8] It is around $160 million while the pre-tax profit is $113 million.

Table 8.2: Average Performance Indicators of Teletas and Netas, 1986-1995

Company	Performance Measure	Pre-Privatisation 1986-88	Post-Privatisation 1989-91	Post-Privatisation 1992-95
TELETAS	*Profitability Indicators*			
	ROS (%)	12.5	14.4	10.3
	ROE (%)	71.3	78.3	53.3
	ROA (%)	15.4	14.6	11.0
	Productivity Indicators			
	GVA (000TL)[1]	60	51	43
	SALEFF (000TL)[2]	125	101	129
		Pre-Privatisation	**Pre-Privatisation**	**Post-Privatisation**
NETAS[(1)]		**1986-88**	**1989-91**	**1992-95**
	Profitability Indicators			
	ROS (%)	4.4	13.6	52.2
	ROE (%)	92.9	169.7	245.0
	ROA (%)	6.3	20.0	43.6
	Productivity Indicators			
	GVA (000TL)[1]	26	47	62
	SALEFF (000TL)[2]	87	97	137

Note: See Table 8.1 above; (1) Netas was privatised in 1993. Therefore, in contrast to Teletas, the period of 1986-1991 is pre-privatisation years for Netas. Nevertheless, to make the comparison easy in average performance calculations, 1992 is included in the post privatisation period which allowed me to compare Netas and Teletas from a cross-company perspective.
Source: See Table 8.1 above.

It looks that the recorded economic performance of Netas is better than Teletas in terms of improvements in profitability ratios after 1989. This may be explained in terms of the sales strategies the two companies have, besides the reason regarding the other operational income discussed above. Evidently, Netas has been pursuing a more vigorous marketing strategy towards foreign markets with the close association of Nortel, and the Turkish private sector along side supplying goods and services demanded by the Turkish PTT. In addition to that, data analysis for both companies shows that the recession hit Teletas harder than Netas. For example, the average production in Teletas declined around 64 per cent when a major economic crisis occurred in 1994, while the decline of average production in Netas was only 36 per

cent in the same year compared to the previous one. This indicates that the output of Netas was as much as twice of that of Teletas in 1994.

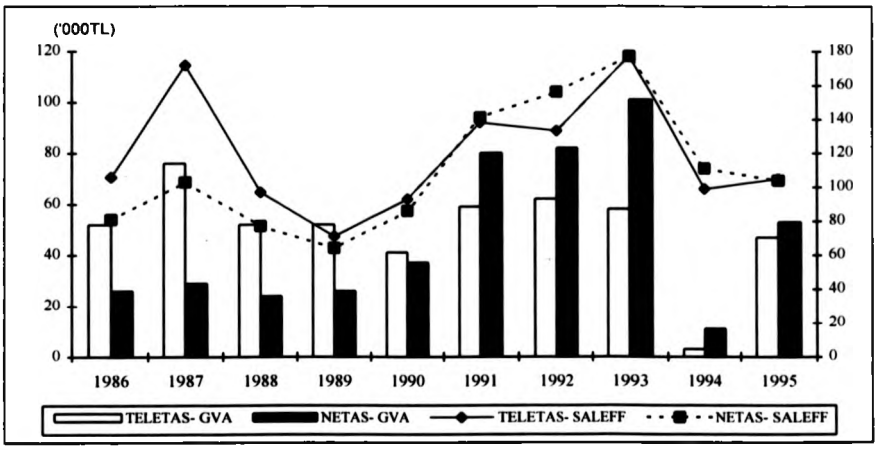
Furthermore, the findings of this research seem to be supporting the above judgement. Indeed, changes in financial terms for Netas have been more favourable over the years. The average rate of growth in gross sales at constant prices was around 20 per cent per annum between 1986-88 for Teletas, whereas the average rate of growth in gross sales in real terms was -2 per cent per annum in the post-privatisation period (i.e. 1989-95). Whilst the same rate for Netas was -1.2 per cent between 1986 and 1988, the average rate of growth in gross sales at constant prices went up to 10 per cent per year in the period of 1989-1995 at constant prices. A similar trend is also observed for profit growth rate in real terms.

8.3.2 Productivity Performance

A detailed analysis of productivity figures for Teletas and Netas is provided in Figure 8.3. It seems that the results presented in Figure 8.3, and Tables 8.1 and 8.2 support the argument that productivity improves under private ownership more rapidly than under public ownership. The empirical evidence in this chapter suggest that the productivity of Teletas and Netas has improved considerably under private ownership despite the downward trend in the Turkish economy after 1987 especially in respect to the telecommunications sector. The productivity analysis is based on two indicators; first, labour productivity is calculated by dividing deflated gross value added generated by the enterprise into the total number of employees (GVA). This represents a real output per employee. A second indicator is sales per employee (sales efficiency- SALEFF). It also uses inflation-adjusted sales figures divided by the number of employees each year. Both indicators, GVA and SALEFF per employee,

are deflated by the WPI. Otherwise, nominal figures in a high-inflation environment such as Turkey would not be helpful to find out much about the productivity of the enterprises examined.

Figure 8.3: GVA and SALEFF per employee in Teletas and Netas at constant prices



Note: GVA per employee = Gross Value Added/No. of employees; SALEFF per employee = Total Sales/No. of employees. All gross value added and sales figures were converted to 1981 constant prices by deflating with WPI based on 1981 prices (1981=100).
Source: Researcher's own calculation. See Tables 8.1 and 8.2 above.

As shown in the figures and the tables, labour productivity figures based on GVA indicate that the output in Teletas was higher in the post-privatisation period except in 1990 and 1994 compared to the pre-privatisation period. In these two years, the economic crises and setbacks in the PTT's investment programme led to lower productivity performance rates.

From cross-company comparison, it can be seen that improvements in labour productivity are more substantial in Netas than in Teletas after 1991, whilst overall average labour productivity for Teletas has been lower in the same period. As the data in Table 8.1 shows, the general trend of the labour productivity over the years in particular starting with 1988 indicates that labour productivity in both firms has been

increasing steadily. Teletas's labour productivity increased from TL52,000 in 1988 to TL62,000 in 1992 at constant prices. The labour productivity of Netas is even more impressive. The output per worker in Netas increased steadily from TL24,000 in 1988 to TL82,000 in 1992. If, however, the labour productivity figures for 1994 which was a difficult year for every enterprise in the country, are not included in this account, the average labour productivity of Teletas in the period of 1992-95 is TL56,000 instead of TL43,000 while the same rate for Netas also goes up to TL80,600 from TL63,000 at constant prices. However, the impressive labour productivity of Teletas in 1987 with TL76,000 is an exception in its pre-privatisation period because 1987 is the year when the number of telephone lines increased about 1.5 million in a single year by contributing significantly to the good financial performance of the company.

Furthermore, it took Teletas and Netas some time to implement modern technologies in their production and to reduce the total workforce which was seemingly larger than required to achieve their production targets. The company reports reveal that investments throughout the early 1990s continued in Teletas and Netas. Their investments were concentrated mainly on computers, machinery and test equipment for the modernisation of production facilities, new product introduction facilities, office modernisation as well as training schemes for the staff. The estimated modernisation investments in 1994, for instance, were $5.7 and $11.9 million for Teletas and Netas respectively (ISE, 1995).

In relation to the employment policy of Teletas, Mr. Yenel stressed how difficult and discouraging it was to try to meet with the unjust demands of the government following Teletas's privatisation. This point was specifically addressed by Mr. Yenel during our interview as follows:

> ... Alcatel Teletas was asked by the government and the Privatisation Administration not to make any redundancy after the privatisation, but when we requested a demand projection from the government's PTT for our products, Alcatel Teletas was unable to get a clear idea of what could be sold to the PTT in the near future (personal interview, January 1996).

Nevertheless, the workforce in Teletas amounted to around 2100, whereas it was 2600 in Netas in 1988. The former gradually reduced its labour force over the years but the radical shake-up occurred during the crisis of 1994. The total number of employees in Teletas was reduced from 1600 to 800 which, according to the company's management, corresponds much more with the real needs of the market and the evolution of the technology. Even though Netas tried to reduce its workforce much more slowly since 1988, the size of its workforce also fell from 2600 in 1988 to about 1500 in 1994. That means that following the privatisation, Teletas has reduced its labour force by 60 per cent and Netas has followed the same downward trend since 1988 but the rate of reduction in the number of employees in Netas has been only around 40 per cent. Having said that, it is reported that following its privatisation in 1993, Netas may continue cutting its workforce further in the years ahead.

The second productivity index, sales per employee (SALEFF) at constant prices, is also given in Tables 8.1 and 8.2. The figures clearly show that both companies recorded significant improvement in sales efficiency in the past seven years. In real terms, the average sales per employee in Teletas first decreased from TL125,000 for the period of 1986-88 to TL101,000 in the first half of the post-privatisation period of 1989-91, and then it reached beyond the level of pre-privatisation, TL129,000, in the period of 1992-95. Similar to these, Netas's sales per employee figures also recorded a considerable increase after 1989 especially in the period of 1992-95. Indeed, while the average figure of sales per employee between 1989-91 remained slightly above the

level of 1986-88, the sales figures per employee recorded an increase of almost twice the level of 1986-88 period and reached TL137,000 between 1992 and 1995.

Putting it differently, the average rate of growth in labour productivity is 7.3 per cent per annum between 1986-88 in Teletas while the rate shows a negative value of 11.3 per cent per annum in the post-privatisation period of 1989-94. The average rate of growth in labour productivity for Netas, on the other hand, is only 2.9 per cent per annum before 1989 but the rate registered a significant increase by reaching 18.1 per cent per annum in 1989-94 period. According to the ICI's survey among 500 major firms, the average rate of growth in productivity also declined from 10.1 per cent between 1986 and 1988 to 7.7 per cent per year in 1989-94 period. The productivity of the private sector, on the contrary, increased from 5.5 per cent in 1986-88 to 7.7 per cent per year in the period of 1989-94.

Besides the quantitative aspects, the impression gained during this research is that both Teletas and Netas seem to be making some steps towards the improvements in their qualitative performance. These two companies claim to provide their customers total communications solutions with the concept of "*total quality*". In particular since 1994, both Teletas and Netas's products and services are supposedly come with a 100 per cent customers' satisfaction at every level from marketing to after sales services. The sale strategy of Teletas and Netas assures customers that any faulty product or unsatisfactory service which fall behind their high standards will be replaced with the new one immediately as a total commitment to customers' satisfaction. However, having said, there is no data available about what the customers respond to these policies, or what the percentage of complaints and returned or unsatisfactory products and services in their total sales are. This is an area which requires further exploration.

In addition to their previous state as successfully run local enterprises, Teletas and Netas have developed, through the years, into technology exporting companies due to the proven capability of their research and development groups to design new and highly competitive products with the use of the state of art technology for the Turkish and the growing telecommunications market throughout the world. Both Teletas and Netas seem to be well positioned and ready to exploit new opportunities through their close associations with the Alcatel Group and Nortel respectively and Alcatel and Nortel's unprecedented experience in the field of telecommunications all around the world. Teletas and Netas are already among Turkey's main technology exporters with a large customer base accumulated from the sale of systems and solutions to more than 20 countries in the American continent, Europe, Commonwealth of Independent States, the Middle East and Africa.

8.4 Conclusion

In this chapter the performance of Teletas and Netas over a ten-year period (i.e. 1986-95) has been examined. The quantitative evidence on Teletas and Netas's performance suggests that there are clear and significant changes in operational efficiency and productivity which could possibly be associated with privatisation.

The review of the quantitative record suggests that as a result of the privatisation of Teletas, and the "announcement effect" on Netas, there have been some improvements in operational efficiency. The operating efficiency of the firms did not change much until 1991. There was an earlier distinct turning point in 1987 in the Turkish telecommunications market. As discussed earlier, until 1987 the massive investments policy of the government in the telecommunications sector resulted in an average growth rate of around 15 per cent per year during the 1980s while the rate has

been only around 3-5 per cent per year in the early 1990s. The performance of Teletas and Netas was affected accordingly from this notable change in the growth rate of the telecommunications sector. However, considerations of longer time-series and cross-company comparisons make it highly likely that the improvements in operational efficiency and productivity were due to the institutional changes as well as the announcement effect of the privatisation in the case of Netas.

Furthermore, Teletas and Netas improved their performance after 1989 through new investments on new technology, better marketing strategies, and product and market diversification as discussed in section 8.3.1 of this chapter. This improvement could be attributed to the privatisation or the announcement effect of the privatisation. The data presented in this chapter shows a clear improvement in productivity and operational efficiency of Netas and a decrease which followed by a slight increase in Teletas's sales productivity following privatisation. However, critics of the privatisation of both companies argue that the downsizing of the labour force which started in 1989 made a significant contribution to their operating efficiency and productivity. The reduction in the number of employees may have had an effect in performance improvements besides the institutional changes that took place. But one can conclude that the reduction in workforce cannot be the only reason for that because, even though the reduction of employee in Netas was 20 per cent lower than in Teletas, Netas's labour productivity figures look much higher in the post 1989 period. Most other variables examined, such as rate of return on equities and assets, either did not change significantly or they changed as a result of factors clearly exogenous to the privatisation exercise such as the economic crisis in 1994. However, these variables showed an identical pattern with the rest of the manufacturing industry and the economy.

How can one explain the correlation found between Teletas and Netas's performance and privatisation? A number of features make the answer particularly difficult. First of all, there may be a need for more extensive research with more detailed data especially about the companies' financial performance over the years. Secondly, it should be considered that some other conditions exogenous to Teletas and Netas may be important. As mentioned earlier, the Morgan Report recommended that the state (PTT) share in Teletas and Netas should be similar after the sale. But Netas could not be privatised and the state held its 49 per cent until 1993. Thus, it remains to be brought in to light whether the continuity of state involvement in Netas's case has anything to do with the relatively better performance of the company in the post 1989 period.

Another question that needs to be addressed here is if the improvements in operational efficiency and productivity observed after 1988-89 would have materialised in the absence of privatisation. The answer to this question would be 'possibly not'. Operating efficiency and productivity improved before and after privatisation as the figures above show, but the rate of change in operating efficiency and productivity was higher under the private ownership despite the fact that Teletas and Netas have been operating in a declining telecommunications market following the boom of the 1980s. Moreover, some other elements such the surge of investments in the early 1990s, the use of more efficient technology and products diversification may also have had an impact on the performance improvements of these companies.

CHAPTER 9: Summary and Conclusions

This concluding chapter is intended to serve two aims: Firstly, it is an attempt to bring together the strands of the different chapters in an effort to appraise what has been observed in the study. Secondly, in the light of such observations, it is to make some deductions from the overall discussions in the study and draw some lessons from the Turkish privatisation.

It may be helpful to recall the main thrust of the study as outlined in both the abstract and introductory chapter. The thrust of this thesis is to provide an analysis of the Turkish case on privatisation against the background of a major economic reform policy (privatisation has been part of it) and the increasing popularity of privatisation around the world. This is done by scrutinising the problems which arose during the implementation of privatisation and pointing out how political, economic and social conditions are crucial in either hindering or enhancing the prospects of carrying it out smoothly. And then in the empirical section, the study turned its focus to the case study of eight privatised enterprises in three different sectors of the Turkish economy.

It will be remembered from the analytical framework developed in chapter one that privatisation of state economic enterprises (SEEs) has been a major economic policy of many countries around the world since 1980. Changing ideological climate and dissatisfaction with the performance of SEEs played an important role in the emergence of privatisation. Privatisation has been considered as a panacea to change the nature and the role of the public sector in the economies of both developed and

developing countries. It was also hoped that privatisation would improve the economic performance of the SEEs and hence the economies they were operating in.

It was also mentioned in chapter one that the policy of privatisation has been justified, designed, and implemented in many different ways. In general, reasons for privatisation appear to be both political (rolling back the frontiers of the state, disappointment with socialism and the failure of CPEs) and economic (the poor performance of SEEs and their heavy claims on public funds). Governments throughout the world have embarked upon privatisation programmes with several goals from the sale of SEEs. Raising money to reduce budget deficits, fostering competition, promoting efficiency and encouraging share ownership are some of the often cited objectives of privatisation programmes in various countries. The policy objectives and motives for privatisation have altered with time and in some cases they have conflictedg with each other. For example, the political rush to privatise and the desire to raise cash prevented many governments from promoting competition in some privatised sectors and made it more difficult to regulate the privatised companies effectively.

The scope of privatisation has been broadened considerably as the process has advanced in the 1980s and 1990s. Several developed and developing countries have started to implement privatisation. Privatisation has been considered as a remedy to severe macroeconomic problems and has been recommended and actively supported by international agencies such as the World Bank and the IMF. Privatisation gained further political significance with the collapse of communism in Eastern Europe. Since then most East European countries have been trying to privatise virtually their whole economies and create a market economy from the ashes of the former CPEs.

Although several governments have committed themselves to privatisation, the degree of commitment, the scale and speed of privatisation differs in various countries, usually reflecting their specific circumstances. Apart from very few developed and developing countries such as the UK, France, Mexico, Chile and Argentina, the vast majority have not succeeded in reducing the size of the public sector substantially.

Among the developed countries, in particular, Thatcher in the UK made privatisation the cornerstone of her government's economic policy in the 1980s. The Thatcher government launched a wide range of privatisation programmes with the pledge of reducing the role of the state in the UK economy. The study noted that the result has been so far the most radical experience with privatisation in terms of shifting the balance between the public and the private sector. The share of the public sector in the UK economy has been reduced to 2.3 per cent from 11 per cent of GDP in 1979. The UK government has privatised almost the entire public enterprise sector. The amount of money generated through privatisation in the UK already exceeded £65 billion in 1995. The British experience also created a valuable opportunity for other countries to learn from the British 'know-how' on privatisation.

Others, however, have not been so successful or capable enough to carry out privatisation yet. Many governments in Europe and elsewhere have chosen a more modest approach by transferring only relatively small shares of the public sector to private ownership. In most developing countries, besides the degree of political commitment to privatisation by governments, there have also been serious obstacles in privatisation such as weak capital markets, legal and financial difficulties, opposition by interest groups and unfavourable macroeconomic conditions. All these factors

seem to have contributed to the slow progress and qualitatively disappointing outcomes of privatisation.

The Turkish case was no exception to this generalisation. As shown in chapters two and three, Turkey abandoned a long-standing 'etatist' development model and adopted a series of policy reforms in the 1980s. The main policy objective of the reform programme (i.e. *the 24 January Decisions*) was to pursue a more market-like approach by reducing the state's scope for economic intervention. The policy of privatisation and public sector reform was part of this broader reform programme.

As discussed in chapter four of this thesis, privatisation in Turkey started in the early 1980s when privatisation was strongly recommended in most developing countries where key sectors had been dominated by SEEs. The initial impetus towards privatisation in Turkey originated from dissatisfaction with the performance of SEEs and the belief that the transfer of SEEs to the private sector would improve their economic efficiency. In the subsequent stages other policy aims, namely raising finance for government expenditure, widening share ownership, and development of the capital markets, were also added.

The assessment of the Turkish experience has, however, shown that from its start in 1986 up to date, privatisation has been implemented discontinuously due to serious political, economic and institutional obstacles. After a decade of privatisation efforts, the results of the Turkish privatisation look disappointing by any standard. None of the major SEEs has been fully privatised yet. The total revenues of Turkish privatisation over the last ten years amount to around $3.1 billion representing only 2.3 per cent of the Turkish GNP. Moreover, during this period Turkish privatisation has undergone significant changes in terms of its objectives, methods and

assumptions. Today, it is clear that privatisation policy has shifted away from its original goals of competition, efficiency, wider share ownership and it has become a revenue generating exercise for the government. Throughout this thesis these differential outcomes of the reform programme including privatisation have been highlighted and as one of the key questions of the study: Why are governments sometimes able to adopt dramatic policy change successfully, but other times they cannot?

This study argues that policy change generates winners and losers, both inside and out of the state. Some actors are advantaged whilst others lose benefits, privileges, power and prestige. The 'costs' of reform provoke intense resistance, and actors- (both pro- and con) often promote their cause by working in concert. The result usually is coalition conflict centred on questions of policy content and the distribution of policy 'costs'. Crucial to the success or failure of the implementation of reforms are: (1) the underlying organisational strength of contending coalitions (i.e. their legal, political, and institutional power resources), and (2) the degree to which policy 'losers' can shift the costs of change to others and/or secure compensation for costs they otherwise would bear. The greater a coalition's organisational strength, the more likely it will prevail in a policy contest, while the more costs actors can offset, the less strident their opposition will be and the easier it becomes to implement new policies. Coalitions, organisational strength, and the policy costs bear decidedly on the outcome of reform initiatives, and for good or for ill, these factors influence a government's ability to implement reforms successfully. Within this setting, several explanations can be given for the apparent failure of the Turkish privatisation programme as illustrated in this study.

As I discussed earlier, Özal's attempts to open the Turkish economy and privatise inefficient SEEs collided head-on with a fifty year tradition and ideology of economic development that placed primary emphasis on the role of the state, not the private sector. The ongoing tension between the ideology of etatism in the sense of an implicit need for a social compact on the one hand, and the belief of the need for social reforms and increasing dissatisfaction with the performance of SEEs on the other, was brought to the surface in the 1980s and it has become part of daily politics since then. There was public dissatisfaction with the numerous privileges given to state-owned and run enterprises despite their heavy losses, but there was also great resistance to any change in the status quo. All these conflicting elements were set in motion when the process of privatisation was started by the Özal government.

The efforts put in by Özal to build up a base of political support for his programme of liberalisation and privatisation were exploited by his opponents in the 1980s, and this exploitation started to threaten Özal's political future. By becoming an 'overpoliticized' and controversial issue, privatisation turned into an obvious target for the opponents of the policy who attacked the government on each and every occasion. Since none of the major political parties was principally against privatisation, they focused on the particular methods employed rather than the overall strategy of the programme. Opposition to privatisation came even from within the government and the management of the SEEs. Many senior politicians leading various parliamentary factions, local politicians from sites hosting SEEs joined the ranks of the opposition and used their political power to undermine the success of the programme as much as they could. The management of SEEs with the support of labour unions openly displayed their views which differed from those of the

Privatisation Administration. The management of SEEs perceived privatisation as a loss of prestige and authority. Even some elements within the private sector that depended on the state-subsidised inputs and rent-seeking policies showed resistance to any change in state capitalism. In particular, less competitive Turkish business interests saw privatisation as a threat with its strong and expanding presence of foreign firms in some sectors of the Turkish economy. The participation of foreign investors in privatisation only helped the critics of the programme to call it a 'foreignization' of the economy.

Building support for a major change like privatisation meant creating a certain degree of consensus among the people, political parties, and interest groups. The inability of the Özal government to accommodate and control these groups effectively not only created a hostile environment for the privatisation process, but different interest groups (or vested interests) from industrialists, wealthy farmers, labour unions, politicians and bureaucrats collectively turned against the government and this resulted in heavy vote losses for Özal's Motherland Party in the second half of the 1980s. The process of undergoing 'democratic consolidation' in the aftermath of the military coup and its impact on Turkish politics made this political and economic transformation process more difficult to handle and to implement a radical policy like privatisation in the late 1980s. Once the relatively authoritarian measures which were inherited from the military period, started to be loosened up one by one, the government increasingly began to face the pressures exerted by different democratic institutions and pressure groups as well as strengthening opposition in the parliament. Based on the experience of other countries, it is argued that privatisation usually proceeds fastest either where a bureaucratic-authoritarian government can pursue

economic policy over the objectives of adversely affected groups (e.g. Chile during the Pinochet years), or where established democracies can build a broad-based political consensus (e.g. the UK and France).

In contrast, it seems that it is significantly more difficult and complicated to proceed with privatisation in countries like Turkey where a major 'democratic consolidation' process is occurring (Önis, 1991b). Partly due to this process, after the 1989 elections, the importance of privatisation for the government was largely overlooked and instead the MP government made a concerted effort to compete with the TPP to enlarge its rural electoral base. A direct manifestation of these efforts involved a striking increase in agricultural subsidies which contributed significantly to the growing fiscal instability in the late 1980s and early 1990s.

This political uncertainty brought with it an unfavourable macroeconomic environment and hence the prospect of a successful privatisation programme was undermined by a deteriorating macroeconomic environment. Even though the Turkish economy was improved profoundly in the early 1980s, there were macroeconomic slippages which undermined the economy in the late 1980s and early 1990s. This adverse macroeconomic situation not only determined the overall performance of the Turkish economy but it also appeared to be an important factor affecting the performance of some of the privatised companies examined in this study. There were several reasons for the instability in the economy such as political-electoral cycles, the restoration of real wages by the unionised workforce and increasing government expenditures which were usually financed through the Treasury. Despite a relative high growth rate of GNP in this period, the persistently high inflation, the inefficiency of SEEs and internal and external debt problems have remained unchanged up to now.

However, it is argued that even if the political and economic obstacles had been overcome, progress on privatisation would still have been slow due to the technical obstacles in its implementation such as a weak capital market and inappropriate institutional framework. In particular, the shallowness of the capital market in terms of its sophistication and volume of trading in Turkey proved to be one of the major problems for privatisation. When the government wanted to go ahead with some of the large share sales in the stock exchange following the initial experiment of Teletas, it became obvious that the ISE could not provide the opportunity to use the stock exchange as a mechanism to privatise SEEs.

The analysis of Turkish privatisation has also demonstrated that the institutional framework for privatisation was unsuitable and inefficient in particular in the early stages of the programme. The centralised structure of the privatisation organisation which encapsulated decisions and implementation within a narrow circle of technocrats, could have achieved fairly successful outcomes if factionalism could have been avoided. Instead, this centralised structure in privatisation helped the growth of favouritism and rent-seeking. Furthermore, the Privatisation Administration which is a body responsible for implementing privatisation in Turkey, had neither the institutional freedom and a well designed legal backing, nor efficient staff to carry out the privatisation programme. Especially in the early stages of the programme, there were few bureaucrats who had the skills needed to design and implement a privatisation strategy. Attempts to ask for foreign assistance and expertise at the early stages of privatisation had to be dropped due to harsh criticism

The political economy of Turkey seems to have also affected the successes or failures of objectives set for the privatised enterprises in the country. One of the major

aims of privatisation in Turkey was to improve the efficiency of SEEs by transferring them into private ownership. So, finding out whether privatisation resulted in improvements in efficiency is one of the key question of this thesis. Before answering the question, it should be stated that the results of the analysis of the performance of privatised enterprises cannot be explained solely in terms of public versus private ownership or the impact of privatisation. The macroeconomic environment may have a crucial importance for identifying and explaining some of the findings presented in the empirical chapters of this thesis. Therefore, any performance analysis in the Turkish context should be made against the background of the macroeconomic circumstances of the country. During the fieldwork, most businessmen emphasised the importance of a stable economy. They stressed that they would like to see the Turkish economy stabilise and improve without frequent economic crises which affect their business activities considerably. Otherwise they believe that, as long as the wild swings in the economy continue to occur, privatisation may not work in Turkey regardless of the methods employed or objectives set by the government. They generally share the view that privatisation will work only to the degree that the rest of the economy works efficiently. Thus, for the business community the stability of the economy is very important not only for a successful implementation of the privatisation but also as a prerequisite for its potential benefits.

It is the observation of this study that the impact of the Turkish political economy did not only determine the outcome of privatisation in the country but it has also had an impact on the performance of privatised enterprises. In terms of primary research, this thesis attempted to analyse the impact of privatisation on some selected privatised enterprises' operating and financial performance. Based on the findings of

three empirical chapters, this study presents some evidence that there are significant improvements in the performance of these privatised enterprises in Turkey in particular in the productivity measures of efficiency employed. However, as already mentioned, frequent ups and downs at the macroeconomic level seemed to have affected the performance of enterprises, albeit the degree of impact varied from one sector to another. It looks as if the telecommunications sector, in particular Teletas because of its special relationship with the Turkish PTT, suffered most in a sector where regular government cut-backs in investment have been common since the late 1980s, and the cement sector perhaps has been influenced least or has been able to cope with crisis better, largely due to a fast growing construction sector in the country. In the post-privatisation period, six privatised firms have shown a rather poor performance in financial terms. The average profitability of the five privatised cement plants has been even below the rest of the public sector cement plants. In the case of Teletas, the company's relationship with its major customer, the Turkish PTT, determined Teletas's poor financial performance in the post-privatisation period of 1989-1995. However, its counterpart, Netas, recorded a much better financial performance compared to Teletas in the 1990s. The case of USAS also showed how a privatised firm could exploit its monopoly position to maximise its profits in a rapidly expanding market. USAS's rate of profitability was exceptionally good in the post-privatisation period.

As elucidated in chapter one, privatisation is justified on the grounds that it improves efficiency by increasing profitability and productivity of privatised enterprises. Hence based upon this assumption, the failure of some of the above privatised companies to produce a better financial performance is somehow puzzling

and requires further and detailed studies. The management of the privatised firms, however, claimed that their low profitability rates are due to the high costs of new investment. It was mentioned that the significant amount of money spent on new investment contributed to the poor financial performance of the companies. Furthermore, the impression obtained during the fieldwork is that some of the privatised companies (e.g. Teletas) concentrated their efforts on their financial survival in an economy where a high rate of inflation and frequent crises occurred during the observation period. Therefore, instead of paying much attention to the improvements in efficiency in their respective sectors, they tried to survive in a turbulent economic period with the least damage to their companies.

In contrast to financial measures such as profitability, nevertheless, the productivity figures employed show that all the privatised firms examined, have made significant improvements in labour productivity. Even though it is still below that of the private sector cement firms, the five privatised cement plants doubled the average output per employee in the post privatisation period. Other productivity measures used (i.e. SALEFF and GVA) also show an increased efficiency in productivity following privatisation. Similar success is also evident for the privatised firms in the telecommunications and airline catering sectors.

Critics of privatisation relate this improvement in productivity to the reductions in labour and the new capital intensive investments made following privatisation. Indeed, improvements in productivity performance could partly be attributable to cuts in the workforce for economic reasons such as problems at the macroeconomic level. One can easily recall that one of the common characteristic of the eight privatisation cases is that foreign firms took part in the process and foreigners are now in control of

these companies and it seems that the foreign management rationalised a seemingly unacceptable level of employment following the privatisation. Almost all the enterprises studied declared massive voluntary redundancies when a major economic crisis emerged or when their respective business was affected because of special economic circumstances in the sector such as the Gulf War which altered USAS's business in 1990-91 period, or the liquidation faced by Teletas in 1994 due to much overdue payments from the Turkish PTT. While the private sector managers are entitled to make these decisions in line with their commercial objectives, the management of SEEs cannot implement similar decisions easily for socio-political reasons.

The reduction in the number of employees may have had an impact on performance improvements besides the new investments and institutional changes that took place. Therefore, this further confirms that; firstly, 'disguised unemployment' in the SEE sector has partly contributed to their inefficiency, and secondly, the above findings also confirm Galal *et al.*'s (1994) hypothesis that performance of divested companies can be affected by the changes the private sector may introduce in the firm after privatisation and the macroeconomic environment. In line with this perspective, this study argues that the reduction in the size of the workforce cannot be the only reason for the efficiency improvement because in the Netas's case, improvements in labour productivity were much better than in Teletas despite cuts in Netas's workforce of 20 per cent less. There is some evidence, however, to suggest that relative improvements in the performance of the companies after privatisation is partly attributable to 'going private' which enabled the management of the companies to

enjoy greater managerial autonomy in decision making in contrast to the financial and bureaucratic regulations of public.

Even though it is difficult at this stage to relate these findings to the rest of the privatised enterprises in Turkey, the emerging evidence suggests that there have been notable improvements in the privatised companies in other sectors of the Turkish economy. Other newly privatised cement plants, dairy industry, animal feed industry and even the troubled iron and steel company, Karabük, are showing some signs of improvements in their performance. Moreover, most of these companies are making new investment in order to improve the quality and diversity of their products in an increasingly competitive Turkish market.

This study of the economic and political analysis of the Turkish privatisation serves as a useful tool for testing policy results in other countries with similar economic and political conditions. The goal was to explain the reasons behind the failure to achieve at least a reasonably satisfactory outcome from the policy objectives of the Turkish privatisation programme. What lessons can one learn from the Turkish privatisation? This study shows that privatisation in relatively competitive sectors such as cement and telecommunications, has been a success. The government has raised money without addressing the issues of regulation in these sectors. There was a reasonable level of competition in these sectors which could be relied upon. Though USAS preserved its monopoly status in the airline catering sector for several years after the privatisation, its privatisation should be, however, considered as a success too in terms of the objectives set by the Turkish government. Evidence, though it is weak and open to qualification, shows that privatisation has contributed to bringing USAS up to international standards in its services. There are claims that the quality, quantity

and diversity of goods and services the company serves, have improved over the years following its privatisation. But the privatisation of USAS also demonstrates how a firm could easily take advantage of its monopoly status in a market and charge its customers high prices for the service it provides.

The experience of USAS could be used for future privatisation efforts in similar circumstances. The Turkish government has not privatised any major SEE yet but it has stated its intention to sell TEDAS (electricity distribution) and Turk Telecom. It would be an interesting task to observe how the government is going to restructure these large enterprises without converting them into private monopolies or what kind of regulatory framework will be established. USAS is a relatively small company compared to TEDAS or Turk Telecom, thus its monopoly power did not affect a large segment of the society but if the government's revenue generating objective overrides promoting competition and increasing efficiency in the electricity and telecommunications as well as other vital sectors, the negative impact of privatisation on consumers is likely to be greater than in the airline catering privatisation.

The analysis of Turkish economic policies shows that the state plays a crucial role in building the market system while protecting its domain of influence. In other words, Turkey's political economy in the 1980s and 1990s presents a paradox which lies at the heart of the political economy of Turkish exceptionalism. Despite the liberalisation and privatisation of the economy, the expected retreat of the state did not materialise. Instead, the state reorganised or reconstituted its role and it even grew slightly. It looks as if the main source for the growth of the state within the economy following the mid-1980s is the overpoliticisation of the economy. In this period, governments increased the rate of public expenditure substantially in order to be

reelected. Furthermore, certain elements of the pre-1980 era, namely the large public sector and rent-seeking behaviour, though in modified forms, continued to manifest themselves.

As far as the Turkish policy environment is concerned, pressures coming from rent-seeking groups overshadowed the economic reform programme and led to inconsistency in policies. However, as depicted in earlier chapters, governments in other developing countries facing similar problems quickly appreciated the importance of coalition building and the ability to control such groups with vested interests that are in a position to hamper a major reform programme such as privatisation. In contrast to the political leadership of other developing countries such as Mexico, Argentina and Chile, the inability of the Turkish government to control the obstructionist impact of vested interests and implement its privatisation programme effectively models the Turkish case as if it is an exceptional one.

In the case of Turkey, it can be noted that a number of factors unique to the country's conditions seem to determine the outcome of privatisation. The role of the above mentioned obstructing elements could be related to an increasingly polarised and fragmented political system which resulted in political uncertainty and macroeconomic instability in the late 1980s and early 1990s, and this consequently crippled the privatisation programme. Furthermore, the failure of the government to develop and maintain consistency through a legal framework that regulates the procedures of its privatisation programme made the implementation of the programme even more difficult. Even the efforts made by decision makers who believe in the need to promote privatisation are hindered by a rigid socio-political inheritance of the past, namely etatism.

All these political and macroeconomic factors have started to affect the success of the privatisation policy and the credibility of the Turkish government and its privatisation programme is undermined in the eyes of public and domestic and foreign investors. Therefore, it is thought that neither the Turkish private sector nor foreign investors have shown as much interest and participation as occurred, for example, in Mexico or Argentina. For the Turkish government, it was naturally difficult to regain the confidence of investors and give a fresh start to the privatisation policy in the late 1980s. It is also argued that the earlier pressures put on Turkey by the IMF and the World Bank to solve its major crisis began to evaporate in the second half of 1980s once the economy started to improve, thus after the mid-1980s, the political leadership has felt less obliged to mobilise political support for its privatisation programme and to implement this politically risky and socially unattractive policy.

The hesitation of the government about whether it should carry on with privatisation and some improvements in the performance of Turkish SEEs in the early 1980s led to conclusions that the performance of state enterprises can be improved without privatising them. However, as shown in this study, these early improvements in performance resulted from the sharp price increases of SEE products and services rather than a genuine efficiency increase. The question that should be asked is whether governments can refrain over a long period of time from the temptation of using SEEs for political goals. The question becomes even more important in the context of developing countries like Turkey, where rent-seeking, favouritism, and political patronage are much in evidence. In that respect, privatisation of SEEs not only brings changes in ownership but it also demonstrates the government's commitment to structural change and market economy.

In the 1990s, there has been no substantial policy change in the government's privatisation strategy. Successive coalition governments have found privatisation easier to design than to carry out. Widespread corruption, favouritism, lack of transparency and allegations of improper conduct became the common elements of privatisation in this period. In 1997, coalition governments first between the religious Welfare Party and TPP and then the present government formed by the Motherland Party and DSP (Democratic Left Party) with the support of smaller parties have so far concentrated their energy on the survival of the fragile coalition rather than on trying to handle the politically sensitive issue of privatisation. Hence, it looks as if the privatisation of Turkish SEEs has been postponed in reality for the time being though the government is trying to give the impression that privatisation is on course.

Having said that, it would not be wrong to predict that regardless of who governs the country, privatisation in Turkey looks as if it is going to occupy an important place in the political agenda. The real ideological shift which has started in 1980 and the widespread belief in the need to change to a more market dominated economy would probably be the main stimulus for the privatisation policy.

With privatisation, the government provides a tangible and largely irreversible signal to the private sector that its primary aim is to cut the umbilical cord between the state and SEEs so that the state can concentrate on its core functions. In that respect, privatisation is just part of a larger policy which aims to establish and/or give a greater role to a market dominated economy, hence privatisation should not be seen as a panacea for all the problems of the economy. In contrast, it can even create new ones such as unemployment and regulatory problems. But as noted, privatisation can also be instrumental for showing the commitment of political leadership to structural

change and a market economy. In order to do that, one also needs a political leadership which possesses political courage, economic vision and credibility. This seems to be a missing element in the case of Turkey at the moment.

In conclusion, this research study represents an attempt at economic and political analysis of Turkish privatisation, a middle-income developing country. This study contributes to research in the area in two main ways: first, it highlights some of the obstacles that the privatisation process in Turkey has faced and the inability of the government to overcome these difficulties which have ultimately halted the process of privatisation in the early 1990s. Second, it explores one of the least investigated areas in the literature; the argument of efficiency brought along with the transfer of ownership from public to private which has intensified with the emergence and spread of privatisation, and then it applies this argument to the Turkish case from the political economy perspective of the country.

The methodology used, however, suffered some limitations which could only be improved through further research, yet the study also gives some grounds for encouragement. It is evident that privatisation could bring economic benefits by increasing the financial performance and productivity of privatised enterprises provided that adverse external factors such as macroeconomic crisis do not occur. Having said that, on the present evidence, it is not clear yet whether privatisation will or will not lead to a sustained improvement in operating performance. The immediate implication of this study for future research is the need to intensify work in this area in both developed and developing countries. Interesting and detailed research could be carried out on the impact of privatisation on efficiency in particular in developing countries. The wave of privatisation in many countries and the lapse of sufficient time

would facilitate such a study. The strategic importance of such studies stems from their implications for future development policies, particularly in developing countries where rent seeking, favouritism and political patronage are common place, as is the domination of a large public enterprise sector.

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