The Turkish Privatization Experience, 1984 to 2009

Marc C. Palmer
Lehigh University

Follow this and additional works at: http://preserve.lehigh.edu/perspectives-v28

Recommended Citation
http://preserve.lehigh.edu/perspectives-v28/9

This Article is brought to you for free and open access by the Perspectives on Business and Economics at Lehigh Preserve. It has been accepted for inclusion in Turkey: bridging two worlds by an authorized administrator of Lehigh Preserve. For more information, please contact preserve@lehigh.edu.
Introduction

The Republic of Turkey began its privatization initiative in 1984 in an attempt to loosen the state’s grip on the economy and move towards more free market principles. In order to understand the Turkish privatization experience, one must first understand the Turkish economy prior to this 1984 initiative. When the Republic of Turkey was established in 1924 by Atatürk, the primary goal was to strengthen the economy. Following World War I, the fledgling country had no industry, no entrepreneurial spirit, and, most of all, no savings. Atatürk tried to focus on implementing liberal, free-market economic policies; however, the economic climate at the time was not yet ready for a move in this direction. Instead, state economic enterprises (SEEs) were formed. SEEs can be used by a government for advancing its industrial economic policies. They are comprised of one or more businesses where the government owns at least a fifty percent share in the enterprise. In order to accelerate economic development, SEEs were formed in Turkey adhering to state-centered economic policies well into the 1950s.

After 1950 the Turkish government again attempted to implement more liberal economic initiatives. However, private sector growth was stagnant, and the government decided that the only way to promote growth was through further expansion of the public sector. From the 1960s to the 1980s Turkey’s economy became increasingly “mixed.” (Ertuna, p. 4) By 1985 SEEs were responsible for nearly 12 percent of Turkish GDP. Since the 1980s, Turkey has followed more liberal economic policies in trying to institute free markets, with the objective of integrating the Turkish economy with the rest of Europe and the world. Thus, the privatization initiative began in 1984. (Ertuna, p. 4)

In the following sections of this article, I first discuss the background of privatization and
how the initiative began in Turkey. In addition, I explain the approach that the government used in setting up the framework for privatization and the difficulties experienced in its early privatization efforts. Finally, I give an overview of the privatization initiative’s success, both economically and socially. Turkish privatization has been a long and difficult process since its inception in the mid-1980s, fraught with legal battles and judicial interventions; however, privatization advanced greatly in the early 2000s and offers a promising future.

**Privatization Background and Turkish Privatization**

Privatization most commonly means the transfer of state ownership of industrial and commercial activities either totally or partially to the private sector through a sale of public assets. Privatization has been one of the most crucial macroeconomic policy issues occupying the agenda of governments of many developed and developing countries since the UK launched a heavy divestiture program in the late-1970s. Privatization processes have crucial social, economic, and legislative effects on the countries that implement such programs; and thus it is not just a simple task of selling state economic enterprises to domestic or foreign corporations. The privatization process needs to be viewed as a multidimensional process and should be implemented with care.

Turkey began its privatization initiative in 1984 when the government commissioned an official report to evaluate the state of the economy and the benefits of undergoing a privatization effort. The results of the study were published in a “master plan” by the Morgan Guaranty Bank in May 1986. (Tecer, p. 4) The explicit objectives for the privatization program were identified in this report as:

1) To transfer the decision-making processes of large corporations and national assets from the public to the private sector to ensure a more effective play of free market forces.
2) To promote competition, improve efficiency, and increase the productivity of public enterprises.
3) To enable a wider distribution of share ownership.
4) To reduce the financial burden of the state economic enterprises on the general operating budget.
5) To raise revenue for the Treasury. (Yeldan, p. 13)

The “master plan” included a list of 32 SEEs that were to be privatized, as well as a plan to designate other enterprises for subsequent privatization. (“Privatization Endeavor in Turkey,” p. 2) Some of the companies that were targeted for immediate privatization were Turizm Bank, Turkish Airlines, Teletas, and the Turkish cement conglomerate, Citosan.

**What Can Be Privatized in Turkey?**

State Economic Enterprises, their subsidiaries, operations, operational units and assets are all available for privatization. (“Privatization Endeavor in Turkey,” p. 4) Public shares and shares in commercial organizations that are not SEEs, but where the majority shares rest with the state, are also available for privatization. In addition, assets producing goods and services with national and supplemental budgets (dams, lagoons, highways, hospitals, ports, etc.) can be placed in the portfolio for privatization as well. In the privatization portfolio there are currently several electric utility and distribution companies, as well as national ports waiting to be privatized.

**Methods of Privatization**

Turkish attempts to privatize public assets generally have comprised three types of sales techniques: block sales, public offers for flotation, and direct sales of assets and facilities of the SEEs and their subsidiaries. The first method is regarded as the least desirable from the point of view of economic competition and efficiency, since it is often the case that block sales of majority shares lead to creation of private monopolies. Public offers and direct sales have been mostly conducted through the Istanbul Stock Exchange, with approvals from the Privatization High Council (a governing body comprised of cabinet officials responsible for the privatization initiative) and the Competition Board (a government commission charged with encouraging economic competi-
As a sales method, privatization via public offering has been limited, while block sales have accounted for more than a third of the privatization receipts. Reliance on block sales as a “big-bang” solution has led to widespread allegations of fraud and corruption as well as undervaluation of the privatized assets.

Privatization Implementations during the Period 1985–2009

Since 1985 state shares in 188 state-owned companies have been privatized. The first privatization attempt in Turkey was the sale of Teletas in 1988. The sale of Teletas, a very profitable company in the telecommunications industry, took place in a public offering with a set price on the Istanbul Stock Exchange. During the privatization, 22 percent of the corporation was sold to the public.

From 1991 to 1997 the leading sectors privatized in Turkey were the cement industry, the iron and steel industries, airport and ground services, aircraft tires, public banks, and electricity and energy. In most cases, state ownership was less than 50 percent in these corporations; and when privatized these shares were either transferred fully to the private firms or sold via the Istanbul Stock Exchange. As can be seen in Figure 1, privatization in Turkey got off to a very slow start, grossing only $9.49 billion in the 20-year span from 1985–2004. As will be discussed in a subsequent section of this article, the dramatic rise in privatization revenue between 2005 and 2009 can be largely attributed to foreign direct investment inflows (FDI) into Turkey during this time period.

Legal Barriers to Privatization

The lack of sufficient attention to the legal framework of privatization has been the most important reason for Turkey’s limited success during the first two decades of the program. The previously mentioned “master plan,” prepared for the government by Morgan Guaranty Bank, included a study of the Turkish legal system to determine the factors that could present possible roadblocks for Turkish privatization. (“Privatization Endeavor in Turkey,” p. 4) The study concluded that the Turkish constitution did not outlaw privatization; however, it noted that the existing legislation was deficient in facilitating the process.

When Turkey began its privatization initiative, it used a 1984 law interestingly enough entitled the Law to Motivate Savings and to Accelerate Government Investments as the basis...
of its legal framework. This law authorized the government to securitize the revenues of hydroelectric dams and toll bridges by issuing “revenue sharing certificates.” (“Privatization Endeavor in Turkey,” p. 2) In June 1986, the law was modified by empowering the Council of Ministers (a body comprised of all of the heads of the major ministries) to decide upon the privatization of SEE’s. This law enabled the transfer of ownership of the SEE’s to the privatization portfolio while automatically granting the SEE the legal status of “corporation,” thus making the SEE one step closer to being a private company. This law, however, did not outline explicitly the role of the government in privatization proceedings and did not provide a sufficient legal framework to administer privatization. Furthermore, it did not solve some of the implementation problems related to labor, managerial, and financial restructuring issues — namely, the special audit requirements to which the SEE’s were subject and certain employment regulations applicable to SEE’s. (Ertuna, p. 15)

According to the Turkish Constitution, SEE’s must be audited by a special auditing body which is not required to abide by the structured rules applied to private companies. As a result, accurate financial records for SEE’s were not accumulated; and when it came time for privatization of an SEE, it was difficult for the government to establish a fair and accurate valuation for the entity. The constitution also requires that SEE’s be managed by government civil servants. Therefore, the management scheme imposed by the constitution did not provide candidates for privatization with the competitive culture needed for success in a free market — namely the ability to employ a properly experienced management team to lead the company. (Ertuna, p. 15) In addition, the newly privatized corporations were forbidden from implementing incentive-based compensation systems that were needed for operating in a free market system.

Unfortunately, Turkey did not think that it had the time to make changes in the law to facilitate privatization and attempted to carry out privatization without making the necessary changes in legislation. This strengthened the position of those who were against privatization in principle, and many of the original privatization cases were challenged in the judicial system and some of the early decisions were reversed.

**Legal Missteps in Early Privatizations**

The 1989 privatizations of the cement producer Citosan and the catering service USAS to foreign investors via block sales provide good examples of the missteps that occurred early on in the privatization endeavor. The sales of both of these companies to foreign investors were undertaken without first being offered to the employees and the Turkish people, as the law required. The controversy led to criticisms by trade unions and the media, and eventually opposition parties brought the debate before the Parliament. (Ficici, p. 10) After a series of legal debates, the Council of State (the highest administrative court in Turkey) overturned the $105 million sale of 51 percent of Citosan’s stake in cement plants to Societe des Ciments Francais and the $14 million sale of USAS to Scandinavian Airlines. (Ficici, p. 11) The Council of State also ordered the government to renegotiate the deals and offer the shares to employees of the two firms in its ruling that privatization should be offered to the Turkish people first. (Ficici, p. 11)

The sale of Petkim in 1990, a profitable, wholly state-owned petrochemical company, was a long and arduous process. Petkim was a monopoly and employed 8,000 workers who had a strong trade union with influential connections with the parties in opposition to privatization. (Ficici, p. 11) The proposed sale brought adverse reactions from the union and political groups that regarded Petkim as a public enterprise that was too important to the Turkish economy to be privatized. In this privatization, the government abided by the law, first offering the shares to Petkim’s employees and to the public. However, when these groups only bought eight percent of the shares, the government looked into selling the rest of the company to foreign buyers. This proposal brought even more opposition from the trade unions who were concerned with job losses and who feared foreign investor participation in the economy. Using their political influence and playing to Turkish nationalism, the unions were able to delay privatization for many years with lawsuits.
Ultimately, Petkim would be sold to SOCAR (State Oil Company of Azerbaijan Republic), Turcas (a Turkish petrochemical company), and Injaz Projects of Saudi Arabia for $2 billion in 2008. (Ficici, p. 11)

The troubled privatizations of USAS, Citosan, and Petkim exemplified the many flaws in early privatization legislation. Mainly, they demonstrated the need for a clearly defined role for the government in privatization proceedings. Furthermore, these cases illustrated the necessity for oversight bodies to ensure that competition and free market principles would prevail and that unions and political lobbyists would have a minimal role in privatizations. Since these needs were not addressed until well into the privatization initiative, costly delays and unnecessary legal battles ensued.

**First Attempt at Legal Reform**

By the early 1990s the government recognized the fact that it needed a comprehensive legal base to accelerate privatization implementation and to meet the objectives set for privatization by Morgan Guaranty Bank’s “master plan.” But instead of passing a comprehensive law to deal with privatization, the government decided to side-step major reform by designing new regulations. (“Privatization Endeavor in Turkey,” p. 3) As a result, a law was passed through Parliament in 1994 empowering the Council of Ministers to issue governmental decrees regulating privatization instead of crafting comprehensive privatization reform legislation. As mentioned before, in the original privatization legislation of 1986 the Council of Ministers’ only power in this regard was to authorize the sales of SEEs. This broadening of the scope of the Council’s authority represented a major change in the privatization process. Soon various decrees were issued in order to accelerate privatization, creating special rules and exceptions to facilitate sales. (“Privatization Endeavor in Turkey,” p. 5) But again this law was challenged in the high court, and both the new legislation as well as the decrees subsequently issued were soon repealed. (“Privatization Endeavor in Turkey,” p. 5) The high court claimed that privatization required legislative action and that privatization authority could not simply be delegated to the Council of Ministers.

**Second Round of Legal Reforms**

On November 24, 1994, the current privatization legislation was enacted in the form of Law No. 4046. The law was welcomed by both citizens and government officials in hopes that it would solve all the privatization problems of Turkey. Public expectations were elevated with intense propaganda by various government agencies claiming that SEEs were “the cause of all ills in Turkey, including inflation.” (“Privatization Endeavor in Turkey”, p. 3) According to the Turkish government, the law served several functions that facilitated the privatization movement. It expanded the scope of assets to be privatized, provided a framework for the transactions to occur, and allocated the proper funds and appropriate mechanisms to speed up the privatization and restructuring processes. (“Privatization Endeavor in Turkey,” p. 2) Furthermore, the law established several government oversight bodies in charge of privatization and a social safety net for workers who would lose their jobs as a result of privatization. In short, the law addressed the major needs that became apparent after the early missteps in the privatization initiative.

**Bodies Responsible for Privatization under Law No. 4046**

Under Privatization Law No. 4046, the privatization process is carried out by two bodies: the Privatization High Council and the Privatization Administration. The Privatization High Council (PHC) is the ultimate decision-making body for privatization in Turkey. The PHC is composed of the Prime Minister, the State Minister, the Minister in Charge of Privatization, the Minister of Finance, and the Minister of Industry and Commerce. (“Privatization Endeavor in Turkey,” p. 2) The PHC nominates SEEs for privatization by placing them in the privatization portfolio. The portfolio consists of a group of SEEs and assets that have been deemed by the PHC to be suitable for privatization. A major criterion for selection is that the company be profitable and therefore attractive to domestic and international investors. (Tecer, p. 9) The PHC then selects certain industrial sectors for privatization at different points in time. Currently, the spotlight is on privatizing electrical distri-
bution grids and shipping ports in Turkey. Furthermore, the PHC is responsible for determining the method and timing of the privatization procedures and ultimately grants the final approval for the sale.

The Privatization Administration (PA) is the executive body for the privatization process. It is a legal public entity that reports directly to the Prime Minister. (“Privatization Endeavor in Turkey,” p. 2) The PA’s major duties include executing the PHC’s decisions, advising the PHC in matters related to the transfer of SEEs into or out of the privatization portfolio, and the restructuring and rehabilitating of SEEs in order to prepare them for privatization. If the PA and PHC deem that an SEE no longer fits their vision for privatization or that the SEE is not sustainable without government intervention, the PA and PHC have the power to remove it from the privatization portfolio.

**Competition Regulations**

Another legal issue addressed in Law No. 4046 concerned protecting the public from the abuses of monopolies, such as excessively high prices for goods, poor quality and service, and an anemic level of innovation. (“Privatization Endeavor in Turkey,” p. 3) Privatization is generally more successful when an SEE is purchased by a non-monopolistic entity in a competitive market. Such an environment usually fosters price competition and higher levels of product quality and customer service. In the case of the privatization of natural monopolies, it is essential that the regulatory environment be well established to eliminate possible exploitation of customers and deterioration of services. (“Privatization Endeavor in Turkey,” p. 3) It took time for Turkey to establish the legal structure to strengthen competition. In 1994, with the passing of Law No. 4046, the Competition Board was established in Turkey with its mission to protect the entire competitive process. The board has the power to resolve disputes between firms, deal with monopoly situations, and oversee mergers and acquisitions. The Competition Board is notified in advance of the sale of an SEE by the purchasing entity to ensure that the transaction does not result in the formation of a monopoly. Only after Competition Board approval does the Privatization Administration authorize the sale. (“Privatization Endeavor in Turkey,” p. 4) In addition, a company whose total market share exceeds 25 percent that desires to take over any SEE needs to obtain a permit from the Competition Board before beginning the tender process. (“Privatization Endeavor in Turkey,” p. 4) These measures are intended to help prevent monopolies from forming. However, even with the far-reaching influence of the Competition Board, many experts feel that it will take still more time to develop the “competitive culture” needed for the success of privatization.

**Privatization after Legal Reform**

Even after the second round of legal reform, net privatization revenues to the Turkish government were meager from 1994–2004. The only sizeable privatization revenue was recorded in 2000 ($2.1 billion) under the close supervision of an International Monetary Fund (IMF) program. Turkey received loans from the IMF to help reduce inflation and lower real interest rates in an effort to make Turkey a more desirable place for foreign investment. The IMF program called for sizable privatization receipts that would limit the growth of the public debt and drastically decrease public investment in SEEs. The results of the program turned out to be disappointing, however, as privatization revenue from 2001–2004 remained low. The most recent IMF agreement, covering the period May 2005 to May 2008, had more ambitious targets for privatization. Turkey’s Letter of Intent, outlining planned economic reforms required in advance of receiving an IMF loan, stated that by the end of 2005 the major public assets of Petkim, Tupras, Edemir, and Turkish Telecom were to be sold. (“Letter of Intent and Memorandum . . . ,” pp. 14–16) The Letter of Intent also stated that the lower bound of the privatization receipts by the end of December 2005 would be no less than $1.5 billion and that the target was to be regarded as a “performance indicator” of the “successful implementation of the IMF Program.” (“Letter of Intent and Memorandum . . . ,” pp. 12–14) In fact, during the calendar year 2005 a total of $8 billion worth of state owned companies were sold, shattering the IMF target of $1.5 billion.
As can be seen from previous Figure 1, privatization revenue in Turkey not only increased dramatically in the year 2005 but remained high through 2008. During this period direct investment by foreign entities in the productive assets in Turkey also exhibited an upward trend. The allure of this foreign direct investment (FDI), along with a stable legal framework and the aid of the IMF, provided the requisite conditions for privatization to be successful. Figure 2 shows the positive correlation between foreign direct investment inflows and privatization revenue. While privatization revenue has increased along with foreign direct investment, privatization revenue has still not increased at the same rate as FDI, hinting that privatization may compete with FDI during periods of economic expansion. This might be due to the fact that FDI offers a simpler and more direct vehicle for investors as opposed to the highly regulated procedures associated with privatization.

Privatization has been continuing strongly in Turkey despite the global economic crisis. In 2008 the final privatization of Petkim was completed for $2 billion as well as another public offering of shares in Turkish Telecom. A push to privatize parts of the Turkish infrastructure culminated in the 2009 announcement that Turkey would sell its 20 electricity distribution networks under a plan to boost investment in an industry where demand is rising by about 8 percent per year. (“Turkey Could Exceed . . .”) Payments for the grid are expected to be more than $7 billion in a direct asset sale. In addition, the rights to operate several ports have been placed in the privatization portfolio to be sold.

**Turkey’s Reliance on Block Sales**

As can be seen in Table 1, the most widely used approach to privatization during the 1985–2009 time period has been block sales. A block sale occurs when a significant portion of an SEE is sold in a private transaction and offers the simplest means to privatization. Block sales in Turkey constituted 52 percent of the offers of public assets, followed by 18 percent in asset sales, and 3 percent in public offerings on the Istanbul Stock Exchange. However, the block sale method is regarded as the least desirable option from the point of view of economic competition and efficiency, since it is often the case that the block sale of the majority of shares can lead to the creation of private monopolies. Still, privatization via block sales is a means for the government to push the process along at a faster pace, allowing for more immediate revenue. This focus on block sales also indicates a shift away from the ideals put forth at the initiative’s onset and toward the goal of just raising revenue to improve the government’s fiscal balance sheet.

---

**Figure 2**

**Foreign Direct Investment and Privatization Revenue from 2002–2008**

![Graph showing FDI and Privatization Revenue from 2002-2008](source: “Privatization Endeavor in Turkey” and “FDI in Turkey.”)
Turkey's Efforts to Help Laid-Off Workers

Along with the growth of the privatization initiative in the early 2000s, Turkey also launched with the help of the World Bank a social support initiative to help affected workers. This initiative, called the Privatization Social Support Program, ran from 2001–2005 and consisted of $250 million of World Bank loans. ("Implementation Completion Report . . .," p. 13) The program created two major channels for helping the Turkish workforce: a job-loss compensation initiative and a labor redeployment service. ("Implementation Completion Report . . .," p. 13)

The objective of the job-loss compensation program was to ameliorate the temporary negative social and economic impact of lost jobs as a result of the privatization of SEEs. This component financed initial severance and ongoing unemployment payments, as regulated by law, to workers displaced due to the privatization of SEEs. Along with severance pay and forced retirement, the Turkish government also set up temporary employment programs for affected workers. Under Law 6574/C, workers laid off from privatized SEEs were given the chance to be temporarily employed by government offices and bureaus. Of the 21,532 workers who applied for this program, 17,731 were granted positions. (Yavilioğlu and Özsoy, p. 26)

The labor redeployment services enacted by the Turkish government were also widely used by affected workers. The objective of this component of the social support program was to aid workers who have been displaced by the privatization of SEEs, including secondary layoffs after the initial employment cuts from the privatization, and to assist them in rapidly re-entering the labor market. This component financed labor training through two major agencies: the Turkish Employment Agency (ISKUR) responsible for aiding unemployed workers, and the Small and Medium Industry Development Agency (KOSGEB) which serves as an incubator for new business formation. Under this effort, ISKUR trained 26,704 workers, with nearly half of them finding new jobs. (Yavilioğlu and Özsoy, p. 26) In addition, KOSGEB developed 6 training centers that served 34,000 workers and launched 533 new firms. The World Bank was encouraged by these results and the commitment that the Turkish government demonstrated to the support programs. In fact, the initiative was extended by the World Bank from 2005–2009 at a cost of $581 million.

Conclusions

This article has examined the privatization initiative in Turkey, with a focus on the legal struggles and challenges that have marked its evolution. With a strong legal framework finally established in the early 2000s and increased foreign direct investment inflow, the stage was set for Turkey's economic liberation. As other nations have realized Turkey's promise and more investment has flowed into the nation, it is
apparent that the initial goal of spreading ownership of SEE's has given way to a focus on quickly producing revenue, as demonstrated by the Privatization Administration's focus on block sales. Turkey's efforts under the World Bank program to help workers retrain and be placed in new jobs have also been an important part of the privatization program and stand to help affected workers well into the future as privatizations continue. As the world economy restructures after the global economic crisis, it will be interesting to see how fluctuations in FDI inflows and investment compete with Turkey's lofty goals for privatization in the coming years.
REFERENCES


Ercan, Metin and Ziya Ön. “Politics within the State: Institutions and Dilemmas of Turkish Privatization in Comparative Perspective.” Koç University. September 2000.


“Privatization Endeavor in Turkey.” The Republic of Turkey Prime Ministry Privatization Administration. 2009.


