10 State-owned enterprises and privatization in Turkey

Policy, performance and reform experience, 1985–95

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Introduction

In the post-1980 era, Turkey's economic policy stance has featured a sustained emphasis on openness in trade and finance, but has lacked a strong commitment to internal adjustment and public sector reforms. The trade policy regime has been liberalized in a gradual but credible manner that facilitated Turkey's accession in 1995 to the Customs Union with the European Union. From 1980 to 1989, the trade reforms were effectively supported by realistic real exchange rates, which yielded an impressive export performance and enhanced Turkey's international creditworthiness. In the post-1989 period, however, the capital account liberalization coincided with the revival of macroeconomic populism in an increasingly contestable political environment, thereby producing unsustainable fiscal and trade deficits. The mismanagement of the macroeconomy eventually led to a major currency crisis in early 1994, to which the government responded with a stabilization programme, entailing considerable social costs in the adjustment period.

As the recent Turkish experience shows, the openness in trade and finance restricts the range of policy instruments available for economic management. This is especially true when currency substitution becomes intensified, and heavy government borrowing distorts flows of funds in favour of the public sector within a shallow financial system. With the reduced government autonomy over trade, monetary and exchange rate policies, an efficient system of public finance gains crucial importance in the pursuit of public policy objectives. To derive greater benefits from market liberalization and increased international integration, structural weaknesses of the public sector also need to be removed, and the institutional basis of private sector development should be strengthened.

In this broad spirit, Turkey's official development plan (1996–2000) envisages a series of structural reforms to bolster the institutional framework of the market system, rationalize the public sector, and promote more vigorous human resources development. Although its ownership is not well-established in Turkey's unstable political environment, the economy-wide medium-term plan nevertheless represents a serious official effort to redefine the role of the state in social and economic development. It calls for the withdrawal of the state from commercial commodity production, more effective handling of the state's regulatory and oversight functions, greater emphasis on social sectors and urban development and broader participation of the private sector in infrastructure investments (State Planning Organization (SPO) 1995a).

At a more operational level, fiscal adjustment is viewed as the centrepiece of the post-1994 adjustment process, which attaches high priority to lowering public deficits and short-term debt stock. The mainstream consensus is that the measures for budget correction (mainly expenditure cuts) need to be complemented by public sector reforms in order to reduce the budgetary burden of public institutions outside the general government, and mobilize new revenues (read privatization) as far as possible. Hence the reform measures for state-owned enterprises and social security system are perceived as key structural components of the ongoing stabilization process.[1]

While the rapid worsening of social security finances is a relatively new phenomenon on the Turkish scene, the financial burden of state-owned enterprises (SOEs) has been a matter of policy concern since the adoption of formal state planning in the early 1960s. Following the post-1980 switch toward a market-oriented economy, the SOE role in manufacturing expansion has been de-emphasized contrary to the prevalent academic opinion favourable to the process of state-led industrialization.[2] In the 1980s, the SOE deficits were contained within financeable limits mainly due to a restrictive policy stance on income distribution. From 1989 to 1993, the SOE deficits quickly widened, however, with the pursuit of populist wage and incomes policies in conjunction with the rising interest burden associated with the new practice of borrowing at market rates. In the wake of the 1994 crisis, SOE borrowing was sharply reduced by deep cuts in wages and investment expenditure (in critical sectors such as energy and telecommunications). Despite the ample rhetoric, the process of privatization has been slow, yielding US$ 2.6 billion in total sales revenue from 1986 to 1995. On the basis of more solid and consistent legal arrangements, the privatization drive is likely to accelerate in the remainder of the 1990s, not so much on the basis of efficiency arguments but 'in response/reaction to the fiscal crisis of the State' as aptly pointed out by Ayubi (1995: 4) in his retrospective on privatization in developing countries.

Against the backdrop of major policy trends, the present chapter provides an evaluation of the aggregate SOE performance and privatization in Turkey during the decade from 1985 to 1995. The essential thrust of our analysis is to construct a consistent basis for the aggregate SOE financial balances, and trace and interpret the observed shifts in performance against the background of the economic policy cycle identified in the 1985–95 period. The present analysis brings out the sensitivity of overall SOE operating surpluses, budgetary transfers and borrowing requirements to changes in major policy characteristics at the macro level. The interpretation of findings is further extended by the consideration of available estimates of public–private productivity differentials and factor shares. Following the evaluation of observed SOE performance, we present a retrospective on Turkey's privatization experience, discuss strategy, methods and legal setbacks, and provide documentation on revenues, expenditures and major asset sales.

The remainder of the chapter is organized in two parts. The first provides background discussions on institutional framework, and outlines the major policy characteristics of successive episodes from 1985 to 1995. In the second section, the chapter first examines the SOE aggregate performance, and then presents an overview of Turkey's privatization experience, ending with the recapitulation of key points.

INSTITUTIONAL BACKGROUND AND POLICY SETTING: THE STATE-OWNED ENTERPRISE SECTOR IN THE TURKISH ECONOMY

Historical background

In the wake of the establishment of the republican regime in the mid-1920s, Turkey quickly discovered the potential role of the state as an owner and producer in industry and services. Although the initial legislation on industrial promotion and state enterprises stressed the eventual transfer of state assets to private industry, subsequent developments in the 1930s and 1940s (connected with foreign exchange shortages) reinforced the use of state enterprises as a vehicle of national development. The ruling elite widely embraced the ideology of statism (an eclectic mixture of capitalism and socialism) in the absence of private entrepreneurship, capital and skills. Notwithstanding the proclaimed economic liberalism of the ruling political party in the 1950s, the state enterprise sector continued to expand in conjunction with the promotion of private industry under heavy protection. The severe payments crisis in the late 1950s was followed by a political regime change (1960), adoption of a new and socially more progressive constitution (1961) and the introduction of formal development planning with the State Planning Organization (SPO) serving as the coordinating agency for planned development.

In contrast to the haphazard policy practice of the 1950s, the post-1961 formal planning approach exercised greater caution in macroeconomic management, attached importance to capital accumulation in industry and benefited considerably from foreign financial assistance The organizing framework was the loosely defined 'mixed-economy system', which allowed the coexistence of public sector and private sector with non-unified rules of the game in their own spheres. The state enterprises were used as direct tools for sectoral and regional development. In turn, private sector development was shaped by restricted trade regimes and financial repression, and encouraged by tax and credit incentives.[3] The early 1970s saw a brief episode of price corrections and export orientation, and a surge in workers' remittances. The response to the 1973 oil shock was reserve decumulation and heavy foreign borrowing, which produced a domestic-demand-led boom, ending with a deep debt crisis in 1978–80. From 1980 onward, Turkey switched to an outward-oriented and market-based economic strategy, which has been researched extensively in the recent literature (Aricanli and Rodrik 1990, Celasun and Rodrik 1989).

In the 1960s and 1970s, the state enterprises proliferated in mining, manufacturing, energy, transport and communications, and banking sectors. Their participation in private joint-stock firms also increased and diversified in an effort to provide additional capital resources to local entrepreneurs. In agro-industries, state enterprises served as institutional devices to support agricultural incomes and influence choices of product mix. The planners' primary motive in expanding this sector was to attain the planned output growth in key industrial sectors to secure the grounds for outward-orientation in later stages. Although not explicitly stressed in the actual planning process, it may also be asserted that state enterprises provided 'regulation by participation in an imperfectly competitive environment in order to prevent the monopolization of the market or exploitation of the consumer' (Adaman and Sertel 1995).

In the pre-1980 era of active development planning, the state enterprises were largely governed within the legal framework of Law 440, which emphasized their commercial nature, but provided large scope for government intervention and limited scope for managerial autonomy. They eventually became burdened by non-commercial objectives, political interference and redundant labour under the umbrella of strong unions.[4] During the foreign financed boom of 1975–7, the non-financial state enterprise borrowing requirement was 70 per cent of the total public sector borrowing requirement (PSBR), which averaged around eight per cent of GNP (in old national income series).

During 1975–7, the total PSBR was financed mainly by central bank credit expansion, which was greatly offset by falling net foreign assets (or rising foreign debt), producing moderate growth of base money and domestic price level. With the sudden termination of foreign lending, a smaller increase in central bank credits had a larger effect on base money and inflation during the episode of the 1978–80 debt crisis (Celasun and Rodrik 1989: 658). Besides a maxi-devaluation, the post-1980 adjustment process therefore entailed steep hikes in state enterprise prices to contain public deficits within financeable proportions, leading to a sharp worsening in income distribution. The latter historical episode justifies policy concerns with state enterprise financial performance, which we analyse further below for the 1985–95 period.

The SOE sector: definition, scope and position in the Turkish economy

For state enterprises, a new institutional framework was introduced by a decree with the force of law (Decree Law 233) in mid-1984. This arrangement contained a clause that allows the government to transfer state enterprises and assets to an extra-budgetary agency for divestiture. In 1986, Law 3291 was legislated to provide a formal legal framework for privatization, which has been revised in later periods as discussed further below.

Decree Law 233 (still in force in 1996) introduced two basic institutional forms: first, state economic enterprises operating on the basis of commercial principles and, second, public economic organizations with monopolistic characteristics, producing basic goods and services (subject to price controls), both of which are totally owned by the state. For both cases, Decree Law differentiates three layers of organization: 'enterprise' (*tesebbus*), 'company' (*muessese*) and 'affiliated partnership'(*bagli ortaklik*). Affiliated partnerships are undertakings with majority shares belonging to an enterprise (Kilci 1994, World Bank 1993). At the end of 1993, the number of so-called enterprises, companies and affiliated partnerships were 34, 120 and 71, respectively, including those in the privatization portfolio.

For the purposes of the present chapter, we refer to the total collection of enterprises, companies and affiliated partnerships defined by Decree Law 233 as state-owned enterprises (SOEs, corresponding to *KIT* in Turkish). It should be emphasized that this coverage excludes SOE participation with minority shares (15 per cent at the minimum) in other enterprises subject to private law. The sales of such minority shares have constituted a notable portion of privatization revenues documented in the last section of this chapter.

A proper review of the SOE sector also requires a distinction between financial and non-financial SOEs. The financial SOEs include major state banks for agriculture, housing and small enterprises, among other smaller units. In the remainder of the present chapter, all our data presentations and evaluations pertain to the non-financial SOEs (*Isletmeci KIT*), unless otherwise noted. For brevity, we shall hereafter refer to the non-financial state-owned enterprises simply as SOEs.

Table 10.1 shows selected indicators to bring out the relative aggregate position of SOEs in the Turkish economy in the post-1985 period. The available estimates show the downward trend in the SOE shares in gross domestic product (GDP) and fixed investment. The employment decline is also notable from 1990 onward. In absolute terms, the total number of SOE personnel were 635,000, 643,000 and 599,000 (including civil servants, contractual employees and workers) in 1985, 1991 and 1993, respectively.

In conjunction with the fall of the SOE share in total fixed investment, it is also observed that the SOE capital formation shifted toward energy, transport and communications at the expense of the manufacturing sector. This shift is definitely a sign of the government's policy bias against public-sector-led industrialization, which has been sharply criticized by a number of researchers (Boratav and Turkcan 1993). Given the budgetary constraints on public investment, it is also important to note, however, the growing importance of highly capital-intensive infrastructure services, which provide complementarities to fixed investments in tradables. In the mid-1990s, Turkey is in fact seeking

Table 10.1 Major indicators of state-owned enterprises in the Turkish economy

A. Share of SOEs in: (%)	*1985*	*1990*	*1993*	
GDP[a]	8.5	7.0	6.5	
Total employment	3.7[b]	3.6	3.1	
Non-agricultural employment	6.8[b]	6.8	5.4	
Total fixed investment	24.0	11.2	7.6	
Public fixed investment	52.7	36.2	26.5	
B. Sectoral structure: (%)	*SOE value added*		*SOE fixed investment*	
	1985	*1990*	*1985*	*1990*
Agriculture	0.5	0.7	0.4	3.0
Industry				
Mining	16.5	11.2	16.5	7.3
Manufacturing	35.9	35.3	24.9	12.2
Electricity	15.8	13.4	28.1	42.8
Transport and communications	24.9	30.1	29.9	34.5
Trade and services	6.4	9.4	0.1	0.1
Total	100.0	100.0	100.0	100.0

Notes:
a based on 'new' national income series.
b 1988 employment data.
Sources: SPO 1996 for A, and Kilci 1994 for B.

private and foreign resources for energy and transport sectors to prevent infrastructural bottlenecks, which may emerge in the near future.

Finally, the review of aggregate SOE indicators would be incomplete without referring to SOE deficits, which we examine later. In 1993, the SOE borrowing requirement, before and after budgetary transfers was 5.2 and 3.6 per cent of GNP (market prices), respectively. The financing requirements of such proportions contrast sharply with the SOE share in GDP (factor cost), which was about 6.5 per cent in 1993 (SPO 1996: 71–2). At the economy-wide level, these figures point to a serious misallocation of resources, and more so if the high real cost of government borrowing is taken into account.

SOE reform efforts outside the privatization process

Following the initiation of the economic liberalization process in the early 1980s, policy measures taken to reform the SOEs may be viewed in three essential parts: first, price deregulation and reduction of monopoly powers; second, institutional restructuring through the passage of Decree Law 233 (in 1984) and its subsequent amendments and extensions; and third, divestiture process. The reform efforts have not involved the exercise of an intermediate option of involving private sector participation in management (rather than ownership). Although a formal framework for privatization was put in place in 1986, the pace was slow in the initial phases, but gradually gained some strength in the 1990s as discussed further in the last section.

The pricing policy issue is important for the SOE financial performance. Until 1984, SOE prices were subject to ministerial control, but were adjusted frequently in 1980–4 to achieve the financial targets set by the stabilization programme. Decree Law 233 provided the legal scope for price deregulation in the 'state economic enterprise' subsector of the SOEs, but limited the pricing autonomy of 'public economic organizations' with monopoly power in their respective spheres (mainly railways, electricity, communications, airlines, airports, tobacco and alcohol). The same legislation also contained a provision, however, for government-specified restrictions on 'state economic enterprise' prices whenever necessary. In a similar vein, the central government was allowed to impose other duties on the SOEs to pursue non-commercial objectives. For both cases of public policy interventions, the central government was obliged to compensate the SOEs (through budgetary transfers) for the loss of foregone profit (officially termed as 'duty loss') calculated in a way that guarantees a 10 per cent profit margin.

In the initial stages, the required budgetary compensation of the SOEs for duty losses was helpful in restraining government interventions in the price-setting process. In the mid-1980s, this particular policy measure was complemented by the removal of legal state monopolies in sugar, tea, cigarettes, some alcoholic beverages and fertilizer distribution. However, with the intensified political contestation in the late 1980s, the political interference in SOE pricing decisions (and their timing) increased without full reflection on duty losses, which were compensated with time lags and without interest in an inflationary environment.[5] Furthermore, the SOE losses connected with the pursuit of non-commercial objectives (such as regional development, maintenance of redundant employment and income support in various forms) have not been subject to explicit assessment and compensation.

With the passage of time, other weaknesses of the SOE institutional framework have also become apparent. They relate mainly to the rigid personnel regime and lack of managerial autonomy, accountability, performance-based incentive systems and – above all – hard-budget constraints. More critically, the SOEs have remained outside the main features of the normal commercial code from 1984 to 1994 until the enactment of Law 4011, which lifted the ban on the attachment and liquidation of the SOE assets due to non-payment of commercial and tax obligations (Tan 1996, OECD 1995). As part of the policy response to the 1994 crisis, the commercialization of the SOEs remaining outside the privatization process presents new possibilities for improved performance in this sector.

Macroeconomic background, 1985–95

Policy mix over time

The aggregate performance of the SOE sector should be evaluated not only against the background of its institutional framework, but also in relation to the economic policy mix and performance at the macro level. In the earlier inward-oriented policy era, a variety of techniques such as financial repression, forced saving, high tariff walls and concessional foreign lending provided a suitable setting for capital formation in the SOE sector, which in turn contributed strongly to output expansion at the aggregate level. In developing countries such episodes often ended, however, with severe payments crisis, requiring large external and internal adjustment and greater reliance on the price system.

As indicated earlier, Turkey has de-emphasized the role of SOEs in manufacturing development, and shifted public investments toward infrastructure sectors in the post-1980 liberalization period. From 1980 to 1989, the policy stance on income distribution was restrained, and real wages were depressed at historically very low levels through labour market repression (Boratav 1990). These arrangements became politically unsustainable from 1989 onward, and subsequent policy shifts had an adverse impact on public finance (Arslan and Celasun 1995).

Concurrent with the reversal of income distribution policies, the capital account was fully opened up in 1989 to complete the process of external financial liberalization initiated in 1984 with the introduction of foreign exchange (FX) deposit system. This policy move (decided by Turgut Ozal at the presidential level) caught all economic agents by surprise, including official planners, who just completed their work on the Sixth Development Plan (1990–4), which projected steadily rising current account surpluses to reduce foreign debt stock. Evidently, the deregulation of capital account aimed at the unification of domestic and world financial markets as a further step toward integration with the international economy in general and the European Union in particular. In our view, another important motive was to encourage and facilitate capital inflows to relax the financial constraint on surging public expenditures.

In unanticipated ways, the capital account liberalization turned out to be a major change in policy regime, involving floating exchange rates, interest-rate arbitrage and reduced effectiveness of monetary policy. The real exchange rate steeply appreciated in 1989–90 with an unfavourable impact on export expansion. Under the new policy regime, an opportunity was created to finance fiscal deficits by domestic borrowing from the banking system on the basis of rapidly increased short-term foreign liabilities of the banks. As correctly pointed out by Ekinci (1996), the short-term nature of capital flows had to be matched by shorter maturities of government bonds. In the presence of high inflation and risk premium, the budgetary burden of interest payments reached unprecedented levels from 1992 onward. Despite the moderated central bank financing of government deficits (until mid-1993), reserve accumulation induced a rapid expansion of base money and thereby fueled domestic inflation.

During 1992–3, the rise in capital account surplus was matched by the deterioration of the current account balance. The domestic counterpart of this process was the sharp fall in public sector saving. In late 1993, the treasury made a series of attempts to lower domestic borrowing rates by greater recourse to central bank advances and cancellation of bond auctions, when PSBR was rising at unprecedented rates. With the eventual collapse of confidence in government policies, financial markets were destabilized, triggering a currency crisis and sharp nominal depreciation (nearly 100 per cent) in early 1994.

On 5 April 1994, the government announced a stabilization programme, which attached high priority to fiscal adjustment and structural reforms in the pubic sector, including privatization and downsizing in the SOE sector. With the support of the IMF stand-by arrangement, the programme's short-term fiscal adjustment targets were largely realized in 1994 and early 1995. The emerging political instability, however, disrupted the implementation of the programme in late 1995.

For our purposes (that is, to trace the impact of economic policies on SOE financial performance), it seems useful to differentiate the following policy episodes over the 1985–95 period:

- 1985–9, trade and financial liberalization and restrained stance on income distribution
- 1990–1, wage boom and capital account liberalization
- 1992–3, foreign financed boom, greater income support to agriculture and interest shock on public finance
- 1994–5, crisis and incomplete adjustment.

Table 10.2 shows the changing configuration of policy characteristics in successive policy phases in a format used in previous research (Celasun 1994). The description of policy mixes is admittedly crude, but captures the salient shifts over time.

Economic performance

Table 10.3 shows the main indicators of Turkey's aggregate economic performance over the policy episodes identified in the preceding discussion. As a cautionary note, we stress that economic performance cannot solely be explained on the basis of policy premises alone, because it also depends on exogenous factors and changes in economic behaviour. Lacking an empirically tested model with a sufficient coverage, we confine our interpretations to a limited number of points that seem to be suggestive. These are the following:

- The aggregate growth in 1985–9 required minimal net foreign saving and benefited from high public saving and realistic real exchange rates. Nonetheless, the domestic inflation remained high. From 1991 onward, the aggregate growth became associated with widened trade imbalances, reflecting larger import penetration and lower export propensity (not shown explicitly in Table 10.3). The rising foreign saving (= current account deficit) in 1990–3 suggests domestic-demand-led expansion in this interval, which was strengthened by real appreciation. The fall and rise in real GNP in 1994 and 1995, respectively, also underline the strong linkage between growth and trade balance. This pattern points to the importance of demand management, while not ignoring the impact of exchange rates and tariff changes on external balance.

- In the historical period, the movements in real exchange rates and real wages seem to be highly correlated with the implication that real depreciations have been validated (in the general equilibrium system) by real wage reductions, which pose a difficult implementation problem. To maintain the price competitiveness of exports, a greater reliance of

Table 10.2 Post-1985 ececonomic policy cycle in Turkey

Policy characteristics	*1985–89*	*1990–1*	*1992–3*	*1994*	*1995*
1 Trade policy					
a Removal of QRs	X				
b *Ad hoc* use of import levies and export subsidies	X				
c Reductions in nominal protection and subsidies		X	X	X	X
2 Domestic finance					
Substantial liberalization	X	X	X	X	X
3 Capital acount					
a Reduced regulation	X				
b Liberalized		X	X	X	X
4 Exchange rate					
a Crawling peg	X				
b Partly managed float		X	X	X[a]	X
5 Demand management[b]					
a Contractionary				X	
b Moderately expansionary	X				X
c Highly expansionary		X[c]	X		
6 Real wages					
a Downward flexibility	X			X	X
b Real wage boom		X	X		
7 Transfers to agricultural producers[d]					
a Low	X				
b Moderately high		X	X		
8 IMF stand-by arrangement				X	X[e]

Notes:

a Currency crisis in early 1994; public announcement of exchange targets from mid-1994 to mid-1995.

b The stance on demand management is based on the comparison of the observed growth rates of domestic demand and GDP over the policy phases.

c Applicable mainly in 1990.

d Based on the estimated of producer-subsidy-equivalent reported by OECD 1994, which provides no data beyond 1993.

e Suspended in late 1995.

Source: author classification of policy characteristics.

Table 10.3 Selected indicators of economic performance, 1989–95

	Annual average 1985–9	1990–1	1992–3	1994	1995[a]
1 Annual change (%)					
Real GNP	4.7	4.8	7.2	−6.1	8.1
GNP deflator	52.5	58.4	65.4	107.3	84.0
2 Index (1985=100)					
Real exchange rate[b]	92.0	111.0	105.0	85.0	98.0
Real labour cost[c]					
Public	106.0	196.0	240.0	222.0	189.0
Private	96.0	141.0	146.0	117.0	121.0
3 External balance (US$ billion)					
Trade balance	−3.1	−8.4	−11.2	−4.2	−13.2
Current account	−0.2	−1.2	−3.7	2.6	−2.3
Capital account	1.0	0.8	6.3	−4.2	5.0
4 Share in GNP (%)[d]					
Saving[e]					
Public	6.0	2.0	−1.9	−1.8	−1.0
Private	18.4	19.6	23.2	24.8	22.0
Investment[e]					
Public	8.7	8.1	6.8	3.7	4.0
Private	16.0	16.2	18.0	17.8	20.5
Total public revenue	21.3	19.0	18.5	20.7	19.7
Primary deficit[f]	1.7	5.2	6.7	0.4	−0.8
PSBR (total)	4.7	8.8	11.4	8.1	6.5
of which:					
SOEs	2.5	4.0	4.0	1.9	0.9
Central goverment	3.0	4.1	5.5	3.9	4.0
Other public sector	−0.8	0.7	1.9	2.3	1.6
Money					
Reserve money	7.6	5.9	7.0	4.8	4.5
Broad money (M2)	22.6	18.3	20.5	16.2	16.6
FX deposits	5.9	6.9	13.1	15.4	17.7

Notes:
a Provisional estimates as of mid-1996.
b Appreciation up.
c In manufacturing.
d Based on 'new' national income series in current prices.
e Saving and investment data in the first column pertain to the 1987–9 period.
f The primary deficit is officially measured as total PSBR minus interest payments in the central goverment budget.
Source: SPO 1995b, 1996. The labour cost estimates for 1994 and 1995 are provisional data.

productivity growth seems to be essential as supported by econometric evidence provided by Arslan and Celasun (1995).

- The growth of real labour costs was indeed massive in 1990–1. This factor accounts for the large drop in public saving and rise in PSBR in this policy episode (see also Arslan and Celasun 1995). The comparison of primary deficit and PSBR values (as per cent of GNP) shows that the interest burden on public finance started to rise from 1992 onward in response to high-cost short-term domestic borrowing, which was in fact the domestic currency counterpart of short-term external borrowing by the banking system. This is supported by data showing the large magnitude of capital account surplus in 1992–3.

- In terms of primary-deficit reduction, the 1994 fiscal adjustment was stronger than predicted, but the budgetary burden of interest payments (as per cent of GNP) reached a higher plateau. While public revenue showed some increase in 1994, the fiscal correction was engineered mainly through cuts in public-sector investment and real wages.
- Finally, the policy sequence and performance observed in 1985–95 suggest that the financial position of the SOE sector may have strong links with wage policy, trade and financial liberalization, income support policies and government-determined fixed investment expenditures. The next section explores such linkages on the basis of available data.

SOE FINANCIAL PERFORMANCE AND PRIVATIZATION EXPERIENCE

SOE financial performance, 1985–95

Determinants of SOE financial performance over time

In order to bring out and quantify the linkages between government policies and SOE aggregate financial performance, we have processed available data in a form that matches the periodization of policy experience reviewed in the previous section. The relevant indicators are expressed as annual averages over the policy episodes and measured as per cent of GNP, complemented by other measures to establish points of emphasis.

The aggregate financial performance of the SOE sector (as defined on page 228) is examined in two stages. In the first stage, the determinants of operating performance are identified, and their change over time is traced. In the second stage, the sources of SOE borrowing requirement, including factors other than operating results, are reviewed. The government policy effects can be differentiated in this two-stage analysis.

Table 10.4 shows the indicators of operating financial performance, including measures on revenues and main components of operating expenses. The key points emerging from the observed performance measures are highlighted as follows:

- In terms of operating surplus generation (measured either in per centage points of GNP or in relation to sales revenue), the performance was positive if not impressive in 1985–90. However, the operating balance turned sharply negative in the post-1990 period. The deterioration is caused partly by revenue decline and to a greater extent by increases in operating expenses. From 1985–9 to 1992–3, the fall in total SOE

Table 10.4 State-owned enterprise operational surpluses (% of GNP)

		1985–9	*1990–1*	*1992–3*	*1994*	*1995*
1	Revenues	25.06	21.85	21.46	23.77	20.08
	of which:					
	Sales	23.49	20.69	20.20	22.29	19.10
2	Operating expenses	23.76	24.23	25.09	26.42	20.79
	of which:					
	a Wages	2.80	4.65	5.10	4.02	3.12
	b Interest payments	1.25	1.47	2.03	2.29	1.28
	c Depr. and provisions	2.27	2.61	2.32	3.15	1.69
	d Other expenses	17.44	15.51	15.65	16.95	14.69
3	Operating surplus/loss (=1−2)	1.30	−2.39	−3.64	−2.65	−0.71
4	Other income/expenditure	−0.82	−0.34	−0.36	−0.42	−0.70
5	Internally generated resources for investment financing (=2c+3+4)	2.75	−0.12	−1.67	0.09	0.28
Memo items:						
	Duty losses accrued on goods sold	0.51	0.59	0.99	0.48	0.31
	Operating surplus/loss adjusted for duty losses	1.82	−1.79	−2.65	−2.17	−0.40
	Wages/sales(%)	11.90	22.50	25.20	18.10	16.30
	Interest payments/sales (%)	5.30	7.10	10.00	10.30	6.70

Source: author calculations based on SPO 1995b, 1996.

operating surplus was nearly 5 percentage points of GNP, which is more than the size of annual public spending on education.

- If the ratio of total operating expenses to total revenues remained constant, the decline in SOE operating surplus (from 1985–9 to 1992–3) would have been 0.2 rather than nearly 5 percentage points, given the observed proportional decline in revenues. These figures underline the negative contributions of the sharp rise in factor costs in the early 1990s, stemming from changes in the institutional and policy environment. From 1985–9 to 1992–3, as expressed in terms of shares in sales revenue, wage costs increased from 12 to 25 per cent, and interest payments from 5 to 10 per cent, while 'other expenses' (mainly covering costs of intermediate inputs) remained proportionally unchanged.
- The post-1990 wage shock stemmed from the reversal of the government's policy stance on income distribution (Onis and Webb 1992, Senses 1992). The rise in interest payments also originated from the change in the government's policy, which shifted borrowing strategy from foreign sources to domestic debt in market terms. The SOE deficits induced by the wage shock were increasingly financed by high-cost domestic bank lending, leading to a rapid build-up of short-term debt in some SOEs. The debt consolidation exercise in 1992 was helpful in curbing further rise in interest payments.
- The declining trend in SOE revenues has a number of causal underpin-

nings such as more rapid real growth of the non-SOE sectors, policy interventions restricting market-responsive SOE price adjustments (some of which are measured by duty losses accrued), impact of trade liberalization on import-competing SOEs and some sales revenue drop due to the exit of a number of cement plants privatized in the early 1990s. The rise and fall in duty losses reflect mainly the policy stance on agricultural income support.

- In the context of adjustment to the 1994 crisis, the SOE operating losses have been reduced in a notable fashion. The reversal in the policy stance on income distribution resulted in lower wage costs and duty losses. The upward price adjustments are reflected in SOE sales revenues in 1994, but it seems that the price correction effort was weakened in 1995. The adjustment at the operational level, discussed later, was supported by investment cuts.

The evaluation of financial performance at the operational level needs to be extended further to crystallize other factors affecting the SOE borrowing requirement (shortly SOE's PSBR), which is measured by the difference between gross investment outlays and available resources as shown in Table 10.5. The SOE gross investment outlays comprise fixed investment and change in stocks, including the inflationary adjustment on stock levels. Resources include internally generated funds (defined on Table 10.4) and budgetary transfers (from the central government budget as well as extra-budgetary funds, also covering the privatization account). Budgetary transfers consist of capital injections, duty loss compensation and aid to the SOE sector.

As indicated earlier, SOEs became an institutional vehicle of the government's drive to develop infrastructure systems in the latter half of the 1980s. As shown in Table 10.5, SOE investment expenditure was high in

Table 10.5 State-owned enterprise borrowing requirement (% of GNP)

	1985–9	*1990–1*	*1992–3*	*1994*	*1995*
1 SOE gross investment	5.82	5.13	3.51	2.61	1.91
Fixed investment	4.23	2.41	1.99	1.36	1.10
Changes in stocks	1.59	2.72	1.53	1.25	0.81
2 Resources for SOE gross investment	3.34	1.17	−0.45	0.72	0.98
of which:					
Internal resources	2.75	−0.12	−1.67	0.09	0.28
Budgetary transfers	0.59	1.29	1.22	0.64	0.70
3 SOE borrowing requirement (SOE PSBR) (=1−2)	2.48	3.96	3.97	1.89	0.92
Memo item:					
SOE PSBR before budgetary transfers:	3.08	5.25	5.18	2.53	1.63

Source: author calculations based on SPO 1995b, 1996.

Table 10.6 Major loss-making state-owned enterprises and their PSBR, 1992–4

	1992	*1993*	*1994*
Share in SOE PSBR (%)			
major loss-making SOEs	7.15	65.9	73.2
of which:			
Soil Products Office (TMO)[a]	16.9	12.5	23.0
Sugar Corporation (TSFAS)	11.8	9.4	3.8
Monopoly Administration (TEKEL)[b]	14.2	21.1	10.0
Hard Coal Mining (TTK)	4.2	4.0	6.4
Electricity Board (TEK)	7.1	0.3	–1.6
Iron and Steel (TDCI)	13.3	10.0	16.6
Railways (TCDD)	4.0	8.6	15.0
Other SOEs	28.5	34.1	26.8
Total SOE PSBR (borrowing requirement)	100.0	100.0	100.0
Memo item: share of 7 loss-making SOEs in total SOE wage bill:	51.0	53.0	47.0

Notes:
a Mainly engaged in state purchase of cereals.
b Tobacco monopoly, also producing alcoholic beverages.
Source: SPO 1995 Annual Programme.

1985–9. It was financed to a considerable extent by internal funds, received mild support from the budget and thereby led to deficits which could be financed by foreign borrowing. In 1990–1, internal resources vanished (as shown in Table 10.4), fixed investment declined, but government's support policies for agriculture resulted in large stock accumulation (mainly, wheat and tobacco purchased above world prices), yielding large PSBR, despite more generous budgetary transfers. In 1992–3, additional investment cuts could not reverse the trend in borrowing requirement, because operating losses increased further (all changes viewed in per centage points of GNP). The SOE's PSBR was eventually lowered in 1994–5 by enhanced operating balances (via real wage cuts) and sharp reductions in fixed and inventory investments (involving deep cuts in infrastructure projects).[6]

The evaluation of aggregate SOE performance brings out strong connections with the government's investment programme, wage and agricultural income support policies, and financial liberalization. Our broad evaluation would be incomplete without a brief reference to the distribution of borrowing requirement within the SOE sector. Table 10.6 shows the largest loss-making SOEs and their shares in sectoral PSBR during 1992–4. The seven largest loss-makers account for about 70 per cent of SOE's PSBR and 50 per cent of the total SOE wage bill. The first three SOEs shown on Table 10.6 are agents of the government's agriculture support policies; and their aggregate deficit was more than 40 per cent of the total SOE borrowing requirement in 1992–3 . It is instructive to note that 'the producer subsidy equivalent', which is a measure of the transfers to agricultural producers from consumers or tax payers due to agricultural policies, increased from 28 per cent in 1988–9 to 41 per cent in 1991 and about 38 per cent in 1992–3 as estimated by OECD for all agricultural commodities in Turkey (OECD 1994: 102).

Complementary indicators of SOE performance

The preceding evaluation of aggregate SOE financial performance may be extended by the consideration of additional indicators estimated elsewhere. Table 10.7 gives data on factor shares of public and private enterprises included in the 500 largest industrial firms regularly analysed by the Istanbul Chamber of Industry. The estimates for factor shares are annual averages for the historical policy episodes identified in the present chapter. These estimates further highlight the vast impact of the post-1989 wage boom on public-sector firms in contrast to the moderate impact on private firms. From 1990 to 1993, the annual average share of labour in (net) value added exceeded 100 per cent in public firms, exhibiting a drastic rise from 43 per

Table 10.7 Factor shares in the 500 largest industrial firms, 1985–94[a]

	Annual average			
	1985–9	*1990–1*	*1992–3*	*1994*
A Factor shares in net value added (%)[b]				
Public firms				
Wages	43.2	103.2	111.4	91.4
Interest payments	35.3	53.4	61.0	53.6
Rents	0.2	0.4	0.3	0.3
Profits	21.3	–57.0	–72.7	–45.3
Total	100.0	100.0	100.0	100.0
Private firms				
Wages	34.5	52.1	49.2	42.2
Interest payments	37.1	27.8	25.1	28.1
Rents	0.6	0.8	0.8	1.0
Profits	27.8	19.3	24.9	28.7
Total	100.0	100.0	100.0	100.0
B Private/public productivity differentials				
Ratio of labour productivities (LP)[c]				
Private LP/public LP	1.5	2.0	2.1[c]	
Ratio of capital productivities (KP)				
Private KP/public KP	3.6	3.9	3.7[c]	

Notes:
a Firms engaged in mining, manufacturing and energy sectors.
b Excluding depreciation.
c For 1992 only.
Source: *Journal of the Istanbul Chamber of Industry* (various issues) for factor shares; and Ozmucur 1993 for labour productivity data. Labour productivity (LP) is defined as net value added per employee, and capital productivity (KP) as the ratio of real net value added to real fixed assets.

cent in the 1985–9 period of wage repression. In the 1990s, the share of interest payments in value added also increased substantially in public firms, reflecting the policy switch toward domestic borrowing in market terms.

Table 10.7 also provides estimates of private/public factor productivity differentials based on earlier research by Ozmucur (1993). Value-added per worker in private firms was one and a half times higher than in public firms during 1985–9, and two times higher in early 1990s, mainly due to labour shedding in response to the wage shock. As expected, the public/private capital productivity differentials are much wider, because of higher capital intensity in mining and electricity sectors, in which public sector participation is greater.

The public/private productivity differentials point to the existence of a considerable scope for static efficiency gains in the industrial SOE sector, if proper reforms are implemented (OECD 1995). In the absence of disaggregated assessments of factor intensities, capacity utilization rates, labour redundancies and market conditions, caution needs to be exercised, however, in arriving at quick estimates of potential efficiency gains at the aggregate level.

Privatization in Turkey

General remarks

In terms of cross-country standards of progress in privatization, Turkey's reform effort has yielded limited results during the past decade (see World Bank 1995, Kikeri, Nellis and Shirley 1992, UNCTAD 1994). In the mid-1980s, the political enthusiasm for privatization was high, but an important opportunity was missed to forge a durable strategy on a sound legal basis. In 1990–3, the divestiture process gained visible momentum, generated a notable rise in revenues, but encountered legal obstacles and reversals with increased labour and political opposition (Sanver 1993). In response to the currency crisis, the 5 April 1994 stabilization programme accorded high priority to privatization, announcing ambitious targets for sales revenues and closures, most of which could not be achieved due to social and legal difficulties. However, the government was able to pass three important legislations in 1994 providing a more enabling environment for privatization, commercialization of remaining SOEs and increased private sector participation in infrastructure build–operate–transfer (BOT) projects. It may be noted that total privatization revenues from 1986 through 1995 amount to US$2.6 billion (in net terms).

In reviewing Turkey's reform experience in the past decade, three key aspects should be emphasized at the outset. First, privatization has been viewed and practiced mainly in its narrow sense, namely divestiture, with limited attention to other forms of private sector participation (with minor exceptions) in SOE management and operations. Second, the policy process has not been sufficiently concerned with capacity-building for the enhancement of the regulatory functions of the state with an eye to establish a competitive market system. Third, SOE reform and divestiture have not been effectively integrated to provide coordination and vision for policy choices and actions (Ertuna 1993).[7]

Against the backdrop of these general observations, the remaining parts of this section present a highly condensed overview of Turkey's privatization experience. The aim is to highlight the broad characteristics of what has actually transpired in the privatization process in an admittedly selective fashion.[8] Hence, a comprehensive review of the privatization controversy and micro-level research remains outside the scope of the present overview.

Legal-institutional arrangements

The institutional arrangements for privatization largely reflect Turgut Ozal's (prime minister, 1984–9 and president, 1989–93) style of political governance, which involved a heavy use of two techniques, namely extra-budgetary funds and decrees with the force of law (decree laws). These mechanisms were amply used to by-pass parliament and regular bureaucracy, centralize control within the prime ministry, facilitate adjustments in the legal framework and increase flexibility in revenue–expenditure management. Such an approach proved to be useful in trade and financial liberalization and implementation of large infrastructure projects, but eventually became too arbitrary and created resentment within the government establishment, thereby reducing elite support for structural reforms in the public sector. The process of privatization was initiated in such a spirit and style with high hopes of speedy implementation.

As noted earlier, Decree Law 233 (introduced in 1984) defined a new organizational framework for SOEs with a clause allowing their divestiture. In 1984, another legislation (Law 2983) created a new extra-budgetary fund agency, the Mass Housing and Public Participation Administration (MHPPA), which would be responsible for the divestiture process (as well as housing development) through the issue of revenue sharing certificates, equity stocks and operating rights. In 1986, Law 3291 established the legal framework for privatization and extended MHPPA responsibilities in the sale of assets and liquidation of units subject to the cabinet guidelines. Law 3291 outlined the procedures for the transfer of SOEs to the MHPPA and their subsequent restructuring and privatization. In 1990, the MHPPA was separated into two extra-budgetary funds: Mass Housing and Public Participation Administration (PPA) by Decree Law 414. The PPA was given the authority to execute the privatization process.

As a legal framework of privatization, Law 3291 remained in force until 1994. It contained, however, a number of features which prevented the applicability of commercial code to companies with more than 50 per cent public share, and limited the flexibility in labour adjustment. Moreover, the High Planning Council (HPC) was given burdensome responsibilities in the governance and control of large SOEs transferred to the divestiture process.

Such burdens definitely reduced the effectiveness of HPC in evolving a coherent medium-term policy framework. In the early 1990s, subsequent legal amendments (through decree laws) attempted to rearrange decision-making responsibilities for SOEs to be privatized, but such attempts created further legal uncertainties in the implementation process (Kilci 1994).

In the aftermath of the 1994 currency crisis, Law 3987 was enacted to authorize the government to carry out and speed up its privatization programme through decree laws. This so-called 'authorization law' was abolished by the constitutional court on the ground that privatization should be regulated by laws rather than decrees. In 1994, a number of new laws and decree laws concerning the privatization of the Turkish Electricity Board and telecommunication services were also abolished by the constitutional court (Tan 1996).

In response to such legal setbacks, a more comprehensive legal framework was legislated in November 1994. The new law on privatization (Law 4046) established the Privatization High Council as a policy-making body, and the Privatization Administration (PA) as a centralized implementation agency, both under the authority of the prime minister. The PA takes charge of the corporate governance of SOEs transferred to its portfolio of assets and units to be privatized subject to the guidelines set by the high council. The new law provides greater flexibility in the choice of privatization techniques, and emphasizes transparency in all transactions.

Furthermore, there are other notable features in the new legal framework. The key innovation is the recognition of labour adjustment issues and redundancy payments. The proceeds of privatization are to be used mainly in meeting the costs of divestiture, labour adjustment and financial restructuring of enterprises in the PA portfolio. For 'strategic' SOEs (defined as monopolies or enterprises important for national security and/or public interest), the state is allowed to retain a golden share with veto powers in corporate decisions. For specified monopoly enterprises and public services (such as railways, postal services, tobacco and alcohol, and telecommunications), the new law allows privatization techniques other than ownership transfer. Law 4046 stipulates the completion of preparatory work for the privatization of all state banks except the 'four main banks', namely the Central Bank, Agricultural Bank, People's Bank (for small enterprises) and Eximbank (for foreign trade) in two years.[9]

The new legal framework (Law 4046) has been supplemented by another legislative act (Law 4107, May 1995) for the privatization of telecom services, allowing the transfer of 49 per cent of ownership, of which 15 per cent is earmarked for the postal office and employees' fund, and 34 per cent for sales to the private sector. The telecom privatization law was partly amended in mid-1996 to strengthen the legal basis for valuation and bidding methods after the annulment of a number of articles by the constitutional court.

A major source of legal difficulties is the absence of explicit statements on privatization in the Turkish constitution. The constitutional court takes the position that privatization is not an unconstitutional practice. However, in its annulment of various privatization laws, the court has adopted certain views and interpretations which have effectively constrained executive action in this area.

In the absence of constitutional guidelines for the transfer of the state ownership and operational control, the constitution court tends to treat privatization as the 'reverse' case of the government takeover (nationalization) of private assets.[10] The constitution contains explicit statements regarding the protection of the property rights of private agents, and requires specific enabling laws for the transfer of private ownership (to the government sector) at realistic rates of compensation. In a similar vein (but in reverse direction), the court rulings stress the need for detailed laws, specifying the conditions under which a particular mode of valuation and privatization (among a predetermined set of alternatives) would apply in the implementation process. The stated concerns of the court are the protection of the overall public interest, preservation of parliament's ultimate authority on matters of ownership transfer and avoidance of arbitrary administrative preferences in the privatization of government property and operations. Moreover, the court which considers certain infrastructure services (such as power utilities and telecommunications) as strategically important for national security and social welfare, expects case-by-case legislation for their privatization and regulation, and takes a critical view of their large-scale sales to foreign nationals and entities.

Notwithstanding the highly cautious stance of the constitutional court on issues of ownership transfer, government officials view the new legislative framework (as of mid-1996) as a more workable and sound legal basis for future privatization. Success will depend, however, on the choice of strategy and strength of implementation, besides other important factors such as the degree of public support and complementary policies for structural adaptation and social safety net.

Strategy and implementation

In the mid-1980s, after introducing the relevant institutional framework, Turkey missed an important opportunity to adopt and evolve a strategic approach to privatization. Based on sectoral assessments, a master plan proposal (prepared by Morgan Guaranty Trust during 1985–6) recommended priority listings and methods of privatization for a bundle of thirty-two SOEs (Aktan 1993, Kjellstrom 1990). Such an approach was considered unsuitable for local conditions and quickly abandoned. In subsequent periods, the objectives and methods of privatization have been subject to frequent turns and twists in response to changing political and market conditions.

At the outset, the main stated objective of privatization was to attain efficiency gains and better resource allocation in a growing market economy. However, in 1986 the High Planning Council added ownership dispersion as

Table 10.8 Privatization revenues, 1986–95 (US$ million)

	1986–93	*1994*	*1995*[a]	*Total*
1 Gross privatization revenues				
Block sale	956.0	7.8	312.9	1,276.7
Asset sale	30.5[b]	4.6	182.8	217.9
Public offering	430.4	2.8	0.0	433.2
International offering	0.0	330.0	0.0	330.0
Sale on ISE[c]	435.9	66.6	19.7	522.2
Total	1,852.8	411.8	515.4	2,780.0
2 Privatization revenues realized[d]				
Block sale	700.4	178.3	264.8	1,143.5
Asset sale	6.1	1.4	151.5	159.0
Public offering	422.0	2.7	0.0	424.7
International offering	0.0	316.3	0.0	316.3
Sale on ISE[c]	435.9	66.5	19.7	522.1
Total	1,564.4	565.2	436.0	2,565.6

Notes:
a As of 31 December 1995.
b Including US$14 million from the sale of incomplete plants.
c ISE denotes Istanbul Stock Exchange.
d Sale proceeds from privatization, including previous year's installments collection.
Source: Privatization Administration 1996a, 1996b.

another key objective. In later periods, the privatization objectives shifted toward fiscal concerns, namely revenue generation for the government and/or deficit reduction in the SOE sector.

Following a number of relatively minor asset sales and public offerings, an attempt was made to accelerate the pace of privatization through block sales of five cement companies and one aircraft catering company to foreign investors in 1989. These sales were not consistent with the 1986 guidelines of the High Planning Council, which emphasized ownership dispersion, and specified target groups of buyers. This inconsistency in government decision-making provided an opportunity for the political opposition to challenge block sales to foreigners in courts, creating a host of legal problems which were resolved in 1992. Foreign investors continue to own and operate these companies.

During 1985–9, total proceeds from privatization amounted to less than US$0.2 billion. In the early 1990s, the process gained momentum, generating sales revenues of about US$1.3 billion from 1990 to 1993. In the aftermath of the 1994 crisis, the announced programme was ambitious, but the implementation was stalled by legal difficulties connected with the revised framework (Authorization Law 3987), which was annulled by the constitutional court. With further legislative efforts, Law 4046 was passed, as noted previously, providing a sounder basis for privatization in 1995. However, the actual proceeds amounted to 10 per cent of the government programme target for privatization revenues in 1995.[11]

Year/Company	*Sector*	*Privatization 1985 revenue (US$ 1,000s)*	*Public share (%)*[a]	*Shares sold*	*Privatization method*	*Purchased by*
1986–9						
Ankara Cimento	Cement	33,000	99.30	100.00	Block sale	SCF (F)[b]
Pinarhisar Cimento	Cement	25,000	99.90	100.00	Block sale	SCF (F)[c]
Subtotal		58,000				
1990–1						
Adana Cimento	Cement	45,077	47.28	47.28	Public offering	
Arcelik	Consumer durables	80,049	9.20	9.20	Public offering	
Cukurova Elektrik	Power generation	85,940	30.15	30.15	Public offering/block sale	Rumeli Elektrik (D)[d]
Erdemir	Iron and steel	151,020	48.60	22.71	Public offering	
Konya Cimento	Cement	27,180	39.87	31.13	Public offering	
Petkim	Petrochemicals	145,805	99.97	7.83	Public offering	
Subtotal		535,071				
1992–3						
Askale Cimento	Cement	31,158	100.00	100.00	Block sale	Ercimsan (D)
Corum Cimento	Cement	35,000	100.00	100.00	Block sale	Yibitas (D)
Denizil Cimento	Cement	70,100	100.00	100.00	Block sale	Modern Cim (D)
Gaziantep Cimento	Cement	52,695	99.73	99.73	Block sale	Rumeli Cim (D)
Ipragaz	Liquid gas	64,066	49.33	49.33	Block sale	Primagez (D)
Iskenderun Cimento	Cement	61,500	100.00	100.00	Block sale	Oyak-Sabanci (D)
Kepez Elektrik	Power generation	33,570	43.68	33.53	Public offering/block sale	Rumeli Elektrik (D)
Ladik Cimento	Cement	57,560	100.00	100.00	Block sale	Rumeli Cim (D)
Netas	Telecomms equipment	110,510	49.00	27.75	Public offering/block sale	NTL (F)[e]
Sivas Cimento	Cement	29,400	100.00	100.00	Block sale	Yibitas (D)
Sanliurfa Cimento	Cement	57,405	100.00	100.00	Block sale	Rumeli Cim (D)
Tofas	Automotive	26,655	39.00	17.87	Block sale/public offering	Fiat (F)
Trabzon Cimento	Cement	32,551	100.00	100.00	Block sale	Rumeli Cim (D)
Subtotal		662,170				

Table 10.9 (continued)

Year/Company	*Sector*	*Privatization 1985 revenue (US$ 1,000)*	*Public share (%)*[a]	*Shares sold*	*Privatization method*	*Purchased by*
1994						
Tofas	Automotive	330,000	21.13	16.67	International offering	
1995						
Havas	Airport handling services	36,000	60.00	60.00	Block sale	Yazeks (D)
Adiyaman Cimento	Cement	52,500	100.00	100.00	Block sale	Teksko (D)
Kumas	Magnesium processing	108,100	99.74	99.74	Block sale	Zeytinoglu (D)
Sumerbank	Banking	103,460	100.00	100.00	Block sale	Ipeks Tekstil (D)
EBK/Ankara	Meat processing	29,209	100.00	100.00	Block sale	
SEK/Istanbul	Dairy products	29,740	100.00	100.00	Block sale	Taciroglu (D)
Metas	Iron and steel	57,900	42.55	42.55	Block sale	Rumeli Hol. (D)
Subtotal		416,909				
Total		2,002,150				

Notes:
a At the time of offering.
b SCF: Societe Cement Français.
c F: foreign.
d D: domestic.
e NTL: Northern Telecom.
Source: Kilci 1994 and Privatization Administration Bulletins.

Table 10.10 Cumulative cash balance on privatization account, 1986–95 (US$ million)

	1986–95	*(%)*
A *Resources*[a]		
1 Privatization revenue	2,566	73.1
2 Dividend income	825	23.5
3 Foreign loans and grants[b]	6	0.2
4 Other cash inflows[b]	112	3.2
Total resources	3,509	100.00
B *Uses*		
1 Transfers to Treasury	558	17.7
2 ISE purchases[c]	134	4.2
3 Transfers to SOEs		
a Capital increase	1,830	57.9
b Credits	145	4.6
c Social aid and labour adjustment	29	0.9
4 Expenditures in privatization		
a Consultancy	34	1.1
b Bidding announcements/public relations	30	0.9
c Payments to related companies	367	11.6
5 Other cash outflows	35	1.1
Total uses	3,162	100.00
C ***Balance on privatization acount***	346	

Notes
a Cash proceeds.
b Applicable only in 1995.
c Denotes Istanbul Stock Exchange.
Source: *Privatization Administration* 1996b.

Table 10.8 shows privatization revenues from 1986 to 1995 and their breakdown by methods of sales. In order to highlight the characteristic features of major privatization cases, Table 10.9 gives a listing of divestitures with sales revenues above US$ 25 million from 1986 to 1995. The cumulative proceeds from twenty-nine major cases account for about 80 per cent of Turkey's total privatization revenue. Table 10.9 also shows that about 70 per cent of the revenues from major cases were realized through block sales (mostly to core investors) and international offerings, thereby indicating the limited contribution of the whole effort to ownership dispersion in the domestic economy.

In turn, public interest also relates to the use of revenues generated in the privatization process. Table 10.10 displays the cumulative cash balance in the privatization account. Although the contents of some expenditure categories (e.g. item 4c) are unexplained, the available cash flow figures (in US$ terms) indicate that the cumulative value of capital injections, credits and transfers to SOEs and their companies in the privatization portfolio is nearly equal to total privatization revenues (excluding dividend income). This evidence suggests that a greater caution needs to be exercised in official medium-term projections of overall public-sector finance, which tend to treat divestiture proceeds as an important source of 'net' revenue.

Implications and conclusions

In Turkey's historical development process, the SOE sector served as an institutional vehicle of industrialization, capacity-building, regional development, employment generation and income support to the agriculture sector. Eventually, the SOE sector became burdened, however, with the proliferation of non-commercial objectives, labour redundancy and political interference. In the post-1980 economic liberalization era, the government policy de-emphasized the role of SOEs in manufacturing development, and shifted the structure of public investment expenditures toward infrastructure sectors (mainly energy, transportation and telecommunications). Despite the diminished role of SOEs in industrial capacity expansions, their assets, operations and labour use are still significant at the national and sectoral levels, and thus provide an ample scope for opportunistic political behaviour in the public policy process.

In the present study, the authors provide a broad evaluation of the SOE sector as a whole (excluding financial state enterprises) from the period 1985–95, which is supplemented by a retrospective on the SOE reform process. The quantitative measures shown in the chapter are derived from the new official data base established in connection with Turkey's Seventh Development Plan (1996–2000), and therefore they may exhibit considerable differences from those provided in earlier research.

The present analysis brings out strong linkages between the aggregate financial performance of SOEs and the government's policy mix at the economy-wide level. The observed shifts in the overall SOE financial position are strongly connected with changes in policy stance on wages and income support to agriculture, government-imposed investment programmes and modes of deficit financing (impacting on interest burden), and also seem to be affected (in ways not precisely quantified) by import liberalization and inflation abatement concerns.

The implications of policy–performance linkages are mainly twofold. First, the observed operational inefficiencies at the enterprise level should not totally be attributed to managerial and technical weaknesses, because they may simply be reflecting costs imposed by public policy choices, which are not adequately compensated by budgetary transfers. Second, any reform process aiming at the commercialization and/or privatization of the SOE sector should squarely face the political task of transferring non-commercial functions (mainly income support schemes and job creation) to the general government (at the central and/or local levels), which requires adaptations in organizational, budgetary and incentive structures. This point has been totally missed in Turkey's reform strategy until recently, and seems to explain – to a considerable extent – insufficient public support for structural reforms in an environment of widely observed income and regional inequalities.[12]

Our retrospective on the institutional aspects of the SOE reform process highlights a number of important points. The commercialization of the SOEs has been unduly delayed until 1994, when the commercial code became partly applicable with the ban on the attachment and liquidation of SOE assets. The process of privatization has been hampered by *ad hoc* approaches to legal arrangements, heavy reliance on statutory decree with the force of law, insufficient dialogue with labour unions, political opposition and local business communities. Furthermore, the overall financial coordination of the SOE sector has been weakened as the number of SOE companies transferred to the portfolio of the privatization agency has grown steadily despite the limited progress in divestiture process.

As part of the reaction to the 1994 currency crisis, the legal-institutional framework of privatization has been substantially strengthened. The new privatization approach features more credible arrangements for labour adjustment issues, which enhance the prospects for accelerated reforms. In recent years, considerable experience has been gained in handling intermediate-size privatization cases. With an eye to sustain fiscal adjustment and restore credibility in structural reforms, Turkey seems to be ready for a bolder divestment effort starting from large enterprises in which investor interest is high.[13] In a complementary fashion, high priority needs to be accorded to the design of regulatory structures for private monopolies and rehabilitation of large loss-making SOEs in order to reinforce the efficiency-enhancing aspects of the reform process.

Notes

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1 See OECD (1995) for a thorough review of the 1994 stabilization programme and related issues.
2 See e.g. Boratav and Turkcan (1993) for assessments of Turkish industrial policies, stressing the role of SOEs together with a critique of neo-liberal approaches.
3 The price distortions caused by these policies had adverse implications for sustainable growth in the longer run. See Hatiboglu (1995) for focused and novel assessments of methodological issues connected with the analysis of domestic terms of trade, productivity differentials and real income growth in Turkey.
4 For a comprehensive analysis of Turkey's SOE experience up to the mid-1970s, see Walstedt (1980).
5 For more detailed observations see World Bank (1993).
6 For the year 1995, the provisional estimates shown on Tables 10.3 and 10.5 for the SOE and total PSBR may have an upward bias. More recent data for 1995 point to the virtual elimination of the SOE's PSBR due to a sharper fall in operating expenses with the implication that the total 1995 PSBR may decline to 5.5–6.0 per cent of GNP. Because of heavier interest burden and widening social security deficit, the total PSBR is projected to rise to around 10 per cent in 1996.

7 In 1992, the government had considered the establishment of a more comprehensive and autonomous institutional framework (TOYOK) for the reforming of the SOE sector, but the draft bill was not enacted by parliament as it was found too cumbersome; for further details see OECD (1993: 25).

8 We draw heavily on Kjellstrom (1990), World Bank (1993), Kilci (1994), Aktan (1993) and Tan (1996). See also Sariaslan and Erol (1993) and various contributions on privatization (with a synthesis paper by Ziya Onis) in the special issue of the *Bogazici Journal* (Bogazici University) vol. 7, no. 1–2, 1993.

9 The public policy functions of state banks and SOEs are discussed and their contributions to industrialization process are emphasized by Senses (1994) in a balanced review of the new privatization law (no. 4046).

10 Our remarks on the constitutional aspects of privatization are based on the constitutional court opinions and annulment decisions reported in the *Official Gazette* no. 22645, 24 May 1996.

11 A notable case of divestiture in 1995 was the ownership transfer of the assets of KARDEMIR, the oldest iron and steel complex in Turkey, to the workers and local groups at the symbolic price of TL1. In the KARDEMIR case, the government assumed all past financial liabilities, the total sum of which (including obligations for severance payments) is unofficially estimated at approximately US$275 million.

12 The status quo bias in SOE governance may also be discussed in the context of 'non-neutral' distribution of gains or losses from the reform. The 'non-neutrality' argument has been examined in different frameworks, emphasizing, for example, differential political capability of pressure groups or uncertainty regarding the identity of gainers or losers from the reform as formally modeled by Fernandez and Rodrik (1991). In Turkey's highly polarized social setting, deeper institutional assessments are needed to explain delays in structural reforms along the theoretical lines of political economy models.

13 The rapid growth of the absorptive capacity of the Istanbul Stock Exchange is a supportive factor for more vigorous privatization efforts in the medium run. From 1989 to 1995, in percentage points of GNP, the stock market capitalization increased from 6.8 to 16.5, and total value traded (a measure of liquidity) had grown from 0.8 to 31.

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