Recent Privatization Experience of Turkey - A Reappraisal

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August 2009

INTRODUCTION

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

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

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the recourse to the constitutional court to launch legal challenges against privatization laws and that the general public was not yet altogether agreeable to the notion of privatization.[2]

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

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

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

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

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

RECENT EXPERIENCE

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

FIGURE 1 NEAR HERE

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

TABLE 1 NEAR HERE

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

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

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

EVOLUTION OF THE LEGAL INFRASTRUCTURE

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

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

Governments tried to reassign decision making authorities on privatizations through a number of laws and decree-laws in the period 1990-1994.[3] As a result of these, the legal basis of privatization became even more complex and disorganized. In 1994 Turkey suffered from a severe currency crisis. Right after the crisis, the government attempted to resolve the privatization quagmire through decree-laws and enacted the "enabling law" 3987. This law did not address privatization directly, but intended to give the government the authority to issue decree-laws. The government issued five decree-laws on the basis of Law 3987, on organizational issues as well as labor compensation schemes. The law was taken to the Constitutional Court by the opposition party members and cancelled by the Constitutional Court. Finally, Law 4046, which still governs the privatization process in Turkey, was enacted in October 1994.

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

The reason for revisiting this history is to underline the fact that governments in the late 1980s and early 1990s did spend quite a bit of effort to enact laws that would enable them to proceed with privatizations. However, the laws that they enacted looked for shortcuts rather then create a solid legal base for a privatization policy.[4] The laws typically gave substantial discretionary authority either to the government or to administrative agencies, and provided little detail on definitions, procedures, methods to be used for privatizations, let alone taking into consideration potential problems that might arise in industries where market power existed. They were designed to undertake privatizations in quite unaccountable and non-transparent ways. Perhaps more importantly, however, these efforts reflected an inadequate understanding of the legal complexities of privatization of state owned assets. Either there was a steep learning curve to go through, or politicians and bureaucrats engaged in designing these laws lacked the capacity to comprehend and deal with these complexities or both.

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

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

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

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

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

The first item reflects that the Constitutional Court would like to have the legislature specify ex-ante and in some detail the authorities of the executive and administrative agencies and the procedures they are going to use when they conduct privatizations. Put differently, the Constitutional Court revealed a preference for less discretion and higher legal certainty at the executive and administrative levels. The concern reflected in the second item has been met by allocating the government a "golden share" in privatizations where the government loses majority control of a strategic enterprise. Such golden share would give the government a say in and authority to approve critical decisions (say changes in the articles of association or mergers with other companies).[5] The third item is perhaps the most interesting: it is simply stating that privatization of natural monopolies should be carried out only if a regulatory framework is established to curb the abuse of market power. This, of course, is consistent with standard normative economic theory of privatization (see below).

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

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

4046 (henceforth Privatization Law) which was a comprehensive and detailed law governing privatizations.[6]

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

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

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

[6] See Ercan and Onis (2001) and Karataş (2001) for more information on the law.

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

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

Competition Policy vs. Regulation

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

Turkey is regarded to be relatively successful.[7] In fact, as will be discussed in more detail below, the role of the Competition Authority in privatizations in Turkey has been quite important thanks to procedural requirements that allow the Competition Board to voice its opinions and give it the authority to approve individual transactions (see below). However, experience in many countries suggests that in a number of industries where severe problems of market power exist, governments have concluded that the ex-post competition policy enforcement is not sufficient to protect the public interest. This is especially true in sectors such as electricity and telecommunications, where incumbent operators have monopoly ownership over an essential facility in the form of a network, which cannot be duplicated by new entrants in a reasonable time frame relevant for the development of competition, and to which new entrants into the industry require access. In such circumstances, most governments also establish a set of ex-ante regulations that require incumbent operators, among other things, to provide access in a non-discriminatory manner to potential entrants that compete with incumbents in downstream or retail markets.

In the absence of such a regulatory framework, the transfer of ownership of network assets to private interests is likely to create serious market power problems and has in principle ambiguous, and most likely negative, welfare consequences.[8] In fact, in such circumstances privatization should be seen as part of the regulatory framework and it needs to be undertaken in a manner which is consistent with the overall objectives of sectoral policy, which often entails the development of competition in the industry.

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[7] See, for example, the peer review undertaken by the OECD (2005)

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

Universal Service

The second general issue that needs to be addressed during privatization has to do with special arrangements that may need to be established to achieve possible distributional and social objectives. Services such as electricity, telecommunications, water and transportation are subject to universal service requirements in most countries, that is, they are treated as services that all citizens should have access to and should be able to consume at reasonable prices irrespective of costs.[9] This may have two dimensions: Providing these services may be too costly in some regions, for example, if this entails significant fixed costs and population in those regions is sparse. Second, the incomes of some households may be too low to purchase these services at regular tariffs, that is, even when costs are not too different from national averages. Such universal service considerations run counter to the logic of private enterprise and market competition and therefore require special regulatory arrangements. Hence an important issue is to what extent the privatization procedure takes account of such considerations.

The Role of the Turkish Competition Authority in Privatizations

The Competition Board decided in 1998 that privatizations by public agencies are to be treated as merger and acquisition transactions and therefore need to be reviewed under merger provision (Article 7) of the Competition Law.[10] The review of the Competition Authority in privatizations appears in two instances. First, if the entity being privatized (1) has a market share over 20 percent, (2) has a turnover exceeding TRL 20 trillion (about €9.5 million) (3)

[9] The term "universal service" is more prevalent in the telecommunications industry. In the European Union, the term "Public Service Obligations" is used in the electricity industry.
[10] See Communiqué 1998/4 and 1998/5 issued by the Competition Board available at the Competition Authority website www.rekabet.gov.tr

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

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

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

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

- In 2000, the purchase of IGSAS, a state firm that manufactured nitrogenous and composite fertilizers, by Toros Gübre, a private fertilizer company was not approved because transaction was deemed likely to create a dominant position.
- In 2004 the Competition Board approved the sale of Tüpraş (a refinery) to a German subsidiary of a Tatarstan-based company, but noted that any new refining capacity investment by the firm would be assessed for entry deterrence effects on potential entrants into the refining market.[11]
- In 2005, the Competition Board denied approval to three privatization transactions involving the purchase of cement plants sold by the Turkish Deposit Insurance Fund. In two of the cases the purchase was denied because it would create dominance, in the third case it was argued that the purchase would have created joint dominance. Failure

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

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

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

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

PRIVATIZATION IN INFRASTRUCTURE INDUSTRIES

Telecommunications

Fixed line telecommunications is a prime example of a network industry. Until 20-25 years ago, the industry was organized as a vertically integrated monopoly, under public ownership in most countries, or as a regulated private company in a few cases, most notably the US. Technological developments and the reduction in the prices of key electronic components made it possible to introduce competition into key segments of the industry. While the local copper network is still considered as an essential facility, the emergence of alternative access technologies is starting to create opportunities for competition even there as well. In any case,

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

Privatization of Türk Telekom, the incumbent operator in Turkey, was initially launched with almost no regard for such a regulatory framework. Decree Law No. 509 (1993) intended to allow the government to transfer the rights to operate the company's assets and sell up to 49 percent of its shares. This decree-law was cancelled by the Constitutional Court because the authorizing law had been cancelled.[12] Turk Telekom was then established trough law no. 4000. However, a critical article of this law, which authorized the Ministry of Transport to determine the rules and procedures to sell 49 percent of TTAS' shares, was cancelled by the Constitutional Court, on the basis that giving such authority to the Ministry amounted to a transfer of legislative authority to the executive and that such procedures had to be specified in law. Then Law No. 4107 was enacted in 1995 that enabled the privatization of up to 49 percent of Turk Telekom; critical articles of this law were also cancelled by the Constitutional Court, basically because it gave too much discretion to the administration (in this case the Privatization High Council) in determining the valuation and sale conditions of Turk Telekom. These challenges forced the governments to develop a less ad-hoc and more structured approach to privatization. A new phase was launched with Law 4161 (1996), which established and a Value Assessment Committee which was also charged with developing sector policy. This law was also taken to the Constitutional Court for

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

cancellation, but it survived the constitutional judicial review. This was followed in 2000 by the enactment of Law No. 4502 which envisaged the termination of Turk Telekom's monopoly rights by 2003 and which established the Telecommunications Authority in charge of developing sector-specific regulations.

The main policy objective in the telecommunications industry is or should be the development of a competitive market that may encourage lower prices, new products and services, technological developments and innovation. In principle the privatization of the incumbent operator may serve as an important instrument to reach these overall objectives. It may be expected that, provided that competition develops, private ownership may render the incumbent operator more flexible, more responsive to changing market conditions and better able to respond to the competitive challenges of new entrants. In the case of Turkey, privatization was also seen as an important step towards the development of competition because many in the industry thought it might reduce the influence of Türk Telekom on the Ministry of Transport and level the playing field. In effect, it is generally agreed that liberalization and the development of competition was derailed because of the prospective privatization of Turk Telekom. The government was focused on the revenues that were to be generated through privatization, and therefore delayed the steps taken towards liberalization, in the hope that existence of monopoly rents would fetch higher privatization prices. In particular, there were significant delays in issuing new licenses, signing interconnection agreements and developing the necessary infrastructure (such as cost accounting) for effective regulation. In retrospect, it was as if at the political level the development of a regulatory framework was seen as an instrument to make privatization legally feasible rather than vice

versa. Put differently, at the political level privatization was the main objective, not the development of competitive markets.[13]

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

Electricity

Privatization is a crucial component of the reform and restructuring program that is being conducted in the electricity industry. The legal basis of the program is Law No. 4628 (Electricity Market Law, later changed to Energy Market Law or EML) that was enacted in 2001. The law envisaged the formation of competitive electricity markets and established the Electricity Market Regulatory Authority (EMRA) to oversee the development of competition,

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

and to design and enforce necessary regulations for access as well as the tariffs of the non-competitive segments. Before examining the role of privatization in the restructuring program, it will be informative to review briefly earlier attempts at attracting private sector investments into the industry.

The government's earlier effort for privatization in electricity entailed attracting private capital through build-operate-transfer (BOT), build operate (BO) and transfer of operating rights (TOR) contracts.[14] In 1991 the Council of Ministers authorized some companies to engage in generation, transmission and distribution of electricity in their respective regions. These were exclusive arrangements with no consideration of competitive markets. Moreover, the authorizations themselves were done without any competitive tendering procedure (hence there was no competition in the market or for the market). In 1996 these authorizations were cancelled by the Council of Ministers. The companies appealed at the Council of State (*Danıştay*, the high appeals court for administrative decisions) and won. With the move towards a competitive model in 2001, this situation created a legal confusion that continues to this day. [15] In 1996 the government launched a new round of privatizations of distribution companies under the TOR model. Bids were collected for 25 distribution regions. Bids for five regions were found insufficient, and five regions faced various forms of legal problems. The agreements of an additional four were annulled by the Council of state and ultimately 11 signed concession agreements which were approved by the Council of State. However, these agreements were not implemented. EML envisaged that these agreements would be amended so that they would be suited to the market model adopted. The supplementary articles of the

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[14] See Atiyas and Dutz (2005) for a discussion of these contracts.

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

law putting time limits for these amendments were cancelled by the constitutional court. Following the enactment of law 4628, a Strategy Document (discussed in more detail below) issued by the High Planning Council in 2004 redesigned the distribution regions and created 21 distribution regions, 20 of which were to be privatized.[16] In short, the legal status of these TOR contracts are extremely vague.[17]

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

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

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

There is now general agreement that development of competition in the electricity industry is extremely difficult, if possible at all, if transmission and distribution activities, which display natural monopoly characteristics, are not separated from generation and retail supply which, are potentially competitive.[18] Such separation would ensure that network operators do not have incentives to foreclose markets to downstream competitors in generation or retail supply.[19] There are various degrees of separation, but legal separation (i.e. organizing different activities under different legal entities which may however belong to the same group) seems to be a minimum requirement. The EU has been pushing for ownership separation of transmission activities, which means that companies engaged in transmission cannot have any control relations in companies engaged in other activities in the electricity industry. Under the EML, transmission is to remain under government ownership. The EML also put some restrictions on the amount of electricity that a distribution company could procure from affiliated generation companies. Different accounts needed to be kept for distribution and retail supply activities (accounting separation) but there was no legal separation.

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

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

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

What was the main concern of the government, then? For one thing, it is likely that the government wanted to get as high revenues as possible, and therefore decorated the distribution assets with monopoly rents, possibly underestimating the welfare costs associated with increased market power. There was possibly a second reason, which was to minimize the risk that the distribution companies could not be privatized. The strategy of the reform program was that the distribution companies would be privatized first and the privatization of generation assets would follow after privatization of distribution assets are almost completed. According to the strategy document mentioned above:[20] "Since the distribution companies, holding retail licenses and operating in a liberal market, have to create confidence on investors engaged or to be engaged in generation activities, privatization will start in the distribution sub-sector." Hence the whole success for the reform program was contingent on the successful privatization of distribution assets.

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

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

It was up to the Competition Authority to upset this arrangement which would have opened the way for the creation of vertically integrated near-monopolies that would have strong incentives to foreclose markets in the future. In its opinion on the privatization of the distribution companies (Competition Authority, n.d.), the Competition Board stated that the Strategy Document seemed to emphasize security of supply and attraction of foreign capital to the neglect of institution of competition and consumers' interests. The Competition Board also stated that the first best approach would be to have ownership separation between distribution activities on the one hand and generation and retail supply on the other. Short of that, the Board stated that legal separation by the end of a transition period (effectively 2011) would be a condition for the approval of privatizations. The condition of legal separation was explicitly stated in the tender specifications.

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

Ports[21]

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

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

Privatization of ports in Turkey has taken the form of TORs. Some smaller size ports under the control of Turkish Maritime Administration (Türkiye Denizcilik İşletmeleri) were privatized between 1998 and 2003. Then in 2004 the Privatization High Council has decided to include in the privatization portfolio six ports under the control of the Turkish State Railways Administration (TCDD). These are the largest ports in Turkey in terms of capacity, connection to railways and highways, infrastructure facilities and hinterland. In its opinion on the privatizations, for some of the ports the Competition Board (Competition Authority, 2005b) listed several structural measures that would prevent the creation of dominant positions. These measures included making room for within-port competition by transferring operating rights to two groups rather than one.[22] In the end, the operating rights of each port were sold to a single operator. According to the Competition Board, as expressed in its decisions approving these transactions, instead of taking the structural measures proposed in the Competition Board's opinion, the Privatization Administration (PA) opted for restricting potential abuse of dominant position through clauses in the concession contract that would limit discrimination, excessive pricing or limiting supply, and require the operator to adopt cost accounting measures.[23] The contract would be enforced and monitored by the Railways Authority. Apparently the Competition Board found these measures adequate.

This is an example of "regulation by contract", whereby a regulatory arrangement is established through the means of a contract which specifies the rules and conduct limitations imposed on the operator over the duration of the contract. However, there are a number of problems with this kind of an arrangement. First, it is not clear at all whether the Railways

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

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

Authority would have the capacity to monitor and enforce the regulatory components of the contract. Regulatory oversight requires resources and specific skills that the Railways Authority does not normally have. In fact, the development of such skills and capacity is one of the main reasons why many countries have opted for the "independent regulatory agency" model to regulate and oversee development of competition in infrastructure industries. Second, the arrangement is completely non-transparent. The concession contract itself is not a public document. How prices are going to be regulated, for example, has not been disclosed to the public and therefore is not transparent. Irrespective of whether enforced by an independent agency or a division in a ministry, the advantage of having an open regulatory framework governed by primary and secondary legislation is that it provides some degree of accountability and transparency to the process; transparency, in turn, is expected to enhance the quality of regulations and their enforcement. The legislation on ports is extremely old, and the recent privatizations were carried out without a sector specific legal framework that would clarify the responsibilities of the different parties and how disputes may be resolved in case they arise.

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

Universal service

As discussed above, liberalization and privatization have made universal service obligations important in both telecommunications and electricity industries, since the functioning of the

market mechanism, even when a reasonable degree of competition is attained, does not ensure that all citizens will have access to basic telephone or electricity services at reasonable tariffs.

In Turkey, in the case of the telecommunications industry, this issue has been addressed through the enactment of a Universal Service Law in 2005. Until the enactment of the law, Türk Telekom was responsible for implementing universal service obligations. According to the law, universal service includes public telephony basic internet and directory services. The basic logic of the law, which is consistent with the approach in the European Union, is that the provision of universal services will be organized in a competitive fashion, and operators which provide universal services will be compensated on the basis of the net incremental cost of the services provided. However, the law has not been applied yet, and effectively Türk Telekom is the monopoly provider of universal services.

Affordability has been an even more important problem in the case of restructuring in the electricity industry. The problem is aggravated by interregional differences in transmission and distribution losses and theft of electricity. In some regions losses surpass 50 percent of consumption. This means that current tariffs entail significant cross-subsidies and that any tariff that would reflect underlying costs would be prohibitively high in the poorest regions of Turkey. Moreover, with rising energy costs cost-reflective tariffs are likely to generate significant energy poverty among low income households in all regions of Turkey (Bağdadioğlu et. al. 2007). The EML had a specific provision for possible support for such households directly from the budget. However, this clause was later cancelled and the government instead chose to continue with cross-subsidies. The government also refused to raise tariffs in the face of rapidly increasing costs until recently, presumably in part due to concerns about distributional consequences. However, this turned out to be fundamentally

inconsistent with the basic market design and with the basic policy objective of the restructuring program, which was to attract new private investment into the industry. In fact, unable to compete with subsidized retail prices of the public distribution companies, some private generators closed shop. While the launching of a short term balancing market in August 2006 has provided a temporary solution to this problem, lack of investment in the interim period has created capacity constraints, driving up wholesale prices, and creating significant losses in the distribution company. A more economically meaningful approach would have been to design an explicit and consistent universal service policy, funded directly from the budget and rely less heavily on distorting retail prices.

A CONCLUDING ASSESSMENT

It has often been argued that governments in the 1980s and 1990s did not seriously pursue privatization because they did not want to lose control over assets that they could use for political patronage and clientelism. The analysis presented in this chapter suggests that this was not always true. In fact, quite a number of governments did want to pursue privatization but in a non-transparent and non-accountable way. These efforts simply did not meet the legal standards set by the Constitutional Court. Note that from a political-economics point of view, losing control over assets is not without benefits: revenues generated through privatization can be used for patronage and clientelism-related expenditures as well.[24]

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

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

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

The availability of a legal framework removes barriers to privatization, that is, of course, if the government is willing to privatize. Clearly the AKP governments that came to power in 2002, soon after the 2001 crisis, showed a strong preference for privatization. What could explain this preference? The extremely high level of public debt that the government inherited from the crisis, and the consequent necessary fiscal adjustment, must have provided strong incentives for privatization. As explained in detail in Ersel (2008), interest payments on debt severely curtailed the volume of current expenditures. The government must have been aware that reducing the level of public debt by privatization revenues would eventually create flexibility in current expenditures (which was indeed created somewhat after 2005, see Ersel (2008)) without jeopardizing fiscal policy significantly. In fact, obtaining revenues was not the only fiscal objective related to privatizations. The other important objective was mobilizing the private sector to undertake necessary investments in infrastructure, which would also help reduce the burden of the fiscal adjustment and create flexibility in current expenditures.

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

Opposition to privatization policies by trade unions continued in the 2000s, if not as strongly as in the earlier period. One of the most frequent tools used by trade unions was to challenge administrative decisions (for example, by the Privatization Authority) pertaining to

privatization by taking them to administrative courts or the Council of State and requesting their cancellation. As discussed above, this strategy lost effectiveness over time, possibly because the Privatization Authority improved its competence in addressing concerns raised during these legal challenges.

From a more normative perspective, one may conclude first of all that in Turkey fiscal considerations of the sort described above have always dominated considerations regarding improvements in long term productivity. In more than one case, a drive to increase the attractiveness of the assets to be privatized and therefore to maximize sale revenues have led governments to delay or neglect measures that were necessary to encourage the development of competition. Even in the case of electricity, where privatization was apparently treated as part of a larger package of restructuring and liberalization, the whole process was dominated by privatization.[25] At a more general level, it seems that the government has seen privatization as a general panacea, and as an excuse to free itself from the task of developing good public policy.

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

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