



TÜSİAD

TURKISH INDUSTRIALISTS' AND BUSINESSMEN'S ASSOCIATION

CONCLUSIONS AND RECOMMENDATIONS
OF TÜSİAD REPORT ON
PRIVATIZATION

(JANUARY, 1992)

TÜSİAD IS A MEMBER OF THE UNION OF INDUSTRIAL AND EMPLOYERS' CONFEDERATIONS OF EUROPE (UNICE)

Cumhuriyet Cad. Ferah Apt. No: 235/2-10 - 80230 Harbiye-Hıdırlar - İSTANBUL - TÜRKİYE - Tel: 22 318 1860-tr
Tel: 146 24 12 - 146 12 05 Fax: 247 00 82



TURKISH INDUSTRIALISTS' AND BUSINESSMEN'S ASSOCIATION

**CONCLUSIONS AND RECOMMENDATIONS
OF TÜSİAD REPORT ON
PRIVATIZATION
(JANUARY, 1992)**

TÜSİAD IS A MEMBER OF THE UNION OF INDUSTRIAL AND EMPLOYERS' CONFEDERATIONS OF EUROPE (UNICE)

Cumhuriyet Cad. Ferah Apt. No: 233/9-10 801 0 Harbiye-Istanbul TURKEY Tlx: 22 318 tsad-tr
Tel: 146 24 12 - 140 2 05 Fax: 147 00 82

INTRODUCTION

TÜSİAD issued a report on privatization in 1986 when privatization studies were still in the initial stages. The report entitled "Privatization, Keys to Success in the Sale of SEEs (State Economic Enterprises) to the Public" was meant to provide a platform for an exhaustive debate over this critical topic. It is, therefore, useful to review some of the report's views on market economy and privatization particularly:

- It is imperative that the state sector withdraw from those areas of the economy that are neither of strategic importance nor of social value. The success of the reforms that aim to strengthen the structures of a market economy and to establish the efficient distribution of resources depend on such withdrawal. Nowadays, it is not necessary for the state to play the lead, to offer guidance to the private sector, as it has now become quite evident that the SEEs can no longer perform their original functions of regulating the economy. In fact, by their inefficiency, they are the cause of serious misallocation of resources. Therefore, privatization is the keystone of a reformist program that seeks to transform the economy in accordance with free market principles.

- For the privatization program to succeed, public opinion first ought to be convinced of the necessity, the benefits and the non-ideological character of the enterprise. The public's support is necessary to secure the continuity and the successful implementation of the program. A large part of the population (businessmen, administrators, civil servants, small investors) could be closely involved in the program in a variety of ways rather than remain bystanders. To this end, extensive use must be made of such instruments as the media, conferences, opinion polls, etc. both to induce the public to accept the program and to determine their readiness to support privatization.

- The government ought to see this program as a means of achieving a variety of social and economic goals and not just as a source of income. This perspective must guide the work done in the preparatory stages and in the implementation of the program. Furthermore, attempts to draw the issue into ideological platforms must be avoided.

Nearly five years have elapsed since the publication of the TÜSİAD report that was based on the aforementioned principles. The current report evaluates the progress made in privatization since 1986, the nature of the problems encountered and the results attained. In the following pages we present a general evaluation of and suggestions for the privatization program.

CHANGING THE TARGET OF PRIVATIZATION

A poll was conducted by Morgan Guaranty and Wyvern Research Associates (WRA) among top civil servants to determine the principal goals of privatization. According to the results of the poll, the first goal in privatizing state owned companies should be "to enable market forces to activate the economy" and the second goal "to increase productivity". "Provision of revenue for the state" ranks as the last goal of privatization, according to those polled.

Yet, in time, it has been observed that the relatively more important goals were left by the wayside. Mr. Sven B. Kjellström from the World Bank's Turkish desk makes the following observation in the World Bank report of November 1990:

"The goals of increasing productive efficiency and productivity were taken over by the drive to finance budget deficits in the privatization strategy since Turkey began implementing the privatization program".

According to B. Kjellström, the goal which ranks relatively the least among the main objectives has become the most important one as time passed. The main goal of privatization in Turkey should be to make an operative market economy.

THE PUBLIC SECTOR CONTINUES TO GROW

In its most comprehensive definition, privatization comprises all the activities that help institutionalizing a market economy and that reduce the economic burden of the state sector. Transferring the ownership of SEEs to the private sector is but one of the aspects of the privatization program.

From this perspective, we detect an important paradox in the country's experience over the past decade. On the one hand, a government trying to restrict the role and

functions of the state, on the other hand, the public sector expanded considerably according to the available statistical data. In the past ten years, the expenditures of SEEs and municipalities and those from non-budgeted funds have increased considerably along with the administrative expenditures accounted for in the consolidated and annexed budgets.

Why do the state and the public sector continue to expand? This question needs to be answered. The most important reason for this is the extreme politicization of the economy during the 1980s. In this decade, the existing economic structure and institutions have seriously deteriorated. The expansion of the state, that is the expansion of public expenditures, eventually necessitates an increase in tax revenue. Moreover, this expansion of the state's expenditures contradicts the logic of the market economy. The following are the consequences of runaway state expenditures in terms of their funding:

- 1) Spending with taxation: Taxes finance public expenditures. Governments, in general, shy away from financing the entire public bill by taxes. Consequently, the fundamental reason for budget deficits is the gap between the rise in expenditures and the increase in tax collection. This also explains the endemic budget deficits in Turkey.

Another important result of spending with taxation is its negative effects on economic growth. Taxes have negative effects on entrepreneurs' ability to invest, total savings, the motivation to work and productivity. This, of course, results in an insufficient or even a negative growth in total market production, hence in the GNP.

- 2) Spending without taxation: An increase in any kind of public expenditure improves the government's chance of reelection. To keep the loss of votes at a minimum, the government tries to finance public expenditures with non-tax resources. Printing money and borrowing are two main such resources. Unfortunately, political experience bears out the fact that Turkish governments have mainly followed this economic strategy for reelection. Increasing public expenditures in election years and resorting to either printing money or borrowing to finance these, are at the heart of our current economic woes.

An increase in public expenditure, whether it be financed by taxation or by non-tax resources, hurts the national economy. It is obviously inevitable that there be occasional state interventions to regulate and stimulate the economy. The critical matter is to determine their nature and limits.

The answer to the question "What ought to be the role and functions of the state?" depends on a country's level of economic development. In the early stages of development, it is appropriate for the state to involve in business activities by establishing SEEs while also undertaking infrastructural investments. This enables it to regulate the economy and guide the private sector. However, at later stages of development, the state must gradually withdraw itself from economic activities and keep its interventions at a minimum. Hence, the state's role must be limited to the provision of security and justice, and the building and maintenance of fundamental structures such as telecommunications, water canals, railroads, airports, highways, dams, ports, etc. **In this sense, privatization is a policy of reducing the role of the state in the national economy and making the market economy operational.**

HOW FAR HAS PRIVATIZATION GONE?

Privatization is first and foremost a matter of timing and planning. The success of privatization depends on careful identification of the tasks to be performed and carefully planned implementation.

Privatization is a long-term strategy. It is certainly not an easy task to sell all the SEEs founded since the establishment of the Turkish Republic in 1923. Hence, privatization must proceed incrementally. Unfortunately, in the past six to seven years, debate in Turkey did not get past the question: "Shall we privatize or not?". This explains the limited progress made in privatization despite a long preparatory period.

For progress to be made and privatization to accelerate, political pressures and interventions on the Public Participation Administration (PPA), which is in charge of the program, must be avoided. Privatization is not an idea peculiar to the Motherland Party's period of government. It must be recalled that in the 1950s the Democratic Party promised privatization but could not deliver on this promise. On

the contrary, this period witnessed an increase in the number of state corporations and their investments. Considering that the SEEs have always been regarded as institutions offering opportunities to dispense political patronage, it is not difficult to discern the reasons why even governments predisposed to privatization cannot succeed in executing it. In short, the PPA must be allowed to plan and execute its program independently.

THE PUBLIC SHOULD BE INFORMED ABOUT THE PRIVATIZATION PROGRAM

The public was not offered a clear and comprehensive account of the privatization program and strategy. Neither the master plan prepared by the Morgan Guaranty Bank, nor the reports on textiles, fertilizers and cement sectors commissioned to foreign consultancy firms were discussed in the press or public platforms. It is indeed difficult to understand why these reports were kept from the experts, academia or concerned institutions. Furthermore, the stubborn secretiveness that was maintained about the sums paid to the consultancy firms led to a proliferation of speculative reports in the press.

The State Planning Organisation translated some sections and the summary of Morgan Guaranty's master plan, but inexplicably these were not distributed to the appropriate persons and institutions. The "Information Memoranda" shared the same fate as these translations. **We consider it beneficial to remind those concerned once more that it is impossible to successfully apply a program without first obtaining the public's support for it.** This is why it is important for the PPA to be open to the public, to be "transparent", in executing its privatization program. It might, therefore, be useful to form a unit within the administration responsible for disseminating information.

A QUESTION OF PRIORITIES

The question of priorities needs careful consideration for the privatization program to succeed. Two topics deserve particular attention in determining priorities:

- The selection of SEEs that can be privatized first.
- Determining the persons/institutions that will buy either some shares or the entire

net worth of SEEs.

The first topic concerns the order in which the SEEs will be transferred to the private sector. Undoubtedly, the issue of privatization is closely related to the economic structure of a country; its level of development as well as the general economic and political climate. The following general evaluation sums up the situation for Turkey: Some of the state enterprises should continue to remain in public hands because of the economic, social and strategic functions they carry while others have completed their historical mission and no longer serve a useful function either for the country or the state.

Morgan Guaranty's master plan analyzes and prioritizes the SEEs in our country on the basis of two criteria: "economic viability" and "investment needs". Morgan Bank's suggestions have partially determined the order of priorities in the execution of privatization in Turkey.

The second topic relates to the question of "to whom the shares of SEEs will be sold first". The potential buyers in privatization are;

- Private investors,
- Institutional investors,
- Employees of the firm,
- Foreign investors,
- Turkish citizens working abroad,
- People of the region where the firm is located.

It is important which one of the above mentioned groups will be given the priority in selling the SEEs. On the subject and priorities, article 18 of the Public Participation Fund Regulations states the following:

"The Board may decide to offer priority or special privileges to the employees in the sale of stock. Local residents may also enjoy priority."

As will be discussed further, the inadequacies of the law on privatization led to some critical problems concerning this issue. Act No. 3291 does not contain any specific provisions as to "whom" the shares will be sold to. Act No. 2983 and the

PPF's regulations based upon this Act couched very general terms and mentioned only "real and legal persons" as potential buyers. These ambiguities generated a lot of problems in the sale of SEEs.

THE POLICY OF SOCIAL PRIVATIZATION AND ESOP

In order to enhance the success of the privatization policy, measures should be taken to secure the purchase of SEE shares by low-income people. The distribution of national wealth to broad segments of the population can be attained by the pursuit of such a **"Policy of Social Privatization."**

The sale of SEE shares to employees, managers and small investors means a transfer of income to these segments. By adding a social dimension to privatization; that is, by this "Policy of Social Privatization", both an increase in productivity and the transfer of this increase in productivity to low-income groups could be achieved. The partnership of the aforementioned groups in SEEs would have a positive effect on income distribution and drastically reduce labor conflicts by merging capital and labor.

The policy of social privatization should be based on ESOP (Employee Stock Ownership Plan). This plan is finding an ever widening area of application in countries like the USA that are seeking to promote economic democracy.

ESOP was implemented in the first application of privatization, which was the sale of TELETAS shares to the public. Several incentives were offered to encourage the company's employees to own stock. The employees ended up with 36.9% of the 22% of TELETAS stock issued and consequently elected one representative to the board of directors. Hence, in the privatization of TELETAS, the aim of promoting employee participation in management was also partially achieved.

THE QUESTION OF FOREIGN CONSULTANTS

Extensive use has been made of foreign consulting firms both in the preparatory stages and the application of privatization programs. It is obviously right to benefit from the experience of foreign consultants. Yet, the fallacious idea that "foreigners know best" has taken root in the process. It is far more rational to consult those

persons and institutions directly involved with the subject. The preparations of the privatization program have been sealed off from all possible contributions from the universities, trade unions, employer unions, experts in the stock market, etc.

Those who prepared the privatization strategy called upon foreign experts for technical assistance on the project. No effort was made, though, to benefit from the experiences and knowledge of those who have previously worked in the rehabilitation and reorganization of the SEEs which are in terms of their history, identified with the Turkish Republic. Some concerned parties criticized the fact that the strategy was enacted solely on the basis of reports prepared by foreigners in a period of five to six months.

THE QUESTION OF SALES TO NON-NATIONALS, "PRIVATIZATION OR FOREIGNIZATION?"

The assessment of privatization is best served by not reducing it to sloganeering. Privatization policy may be the means to accelerate the rate of foreign investment in the country. Hence, a sale to non-nationals is not a "selling off of our national institutions to foreigners." As in other cases, the important point is to set priorities correctly. The SEE stock should be first offered to employees and the public. Given the quantitative prevalence of the SEEs in the national economy, it is quite obvious that not all of these could be privatized by this method. Therefore, foreign investors are as important as domestic private and institutional investors. The right policy in such sales is to abstain from selling the shares and/or the assets in block. In the course of privatization so far, "sales to non-nationals" has come under heavy criticism. The sale of ÇİTOSAN and US AŞ have been challenged in court. These developments will certainly have an unfavorable impact on future sales to foreign investors.

Yet, the failure of the ÇİTOSAN and US AŞ sales is related more to the following factors than to the fact that the buyers were foreign:

- 1) Inadequate formulation of the legal norms regarding privatization.
- 2) Problems related to the determination of the selling price.

Act. 3291 does not decree who the sale should be made to. Although Act. 2983 decrees that real and legal persons can purchase SEE stock, it does not specify

whether these should be "national" or "non-national". The regulations of the Public Participation Fund (PPF) do not contain any specific item on sales to non-nationals either. ÇİTOSAN and USAŞ were included in the program of privatization by Resolution 54 of The Mass Housing and Public Participation Administration (HPPA). The said resolution states that:

"... it is decided that the public shares in firms and corporations included in the privatization program should be sold primarily to the employees, local residents, small investors, workers in foreign countries and to the public at large".

It is clear that this decision does not make any mention of sales to non-nationals. As a matter of fact, the ruling of the First Administrative Court of Ankara rests on this omission.

The second factor that generated problems was the price quoted for block sales to non-nationals. The Morgan Guaranty report identified the "reduced cash flow method" as the most appropriate and dependable method in determining the selling price.

In December 1984 the price for USAŞ calculated by this method was set at \$ 64 million. Nearly four years later USAŞ was sold for TL 32.014.8 million, which was the equivalent of \$ 14.450.000. In addition the sales contract specified that 21% of net profits would be received over the first 10 years.

The controversy over the sale of ÇİTOSAN and USAŞ that took place in the press, led to an incorrect assessment of these transactions, as expressed in the slogans, "we are losing the state sector" and "national institutions are being sold to foreigners."

To repeat, it is wrong to speak of "foreignization" because the SEE shares or assets have also been offered for sale to non-nationals as well. It is impossible for national individual and institutional investors and employees to purchase all of the existing SEEs. Therefore, there is nothing wrong with selling some of the SEEs directly to investors abroad. In the course of such transactions, however, attention must be paid to the following:

- Transfer of new technology.
- The promise of the investor to contribute to the country's exports and to earn hard currency.
- The question of monopolization in the sector following privatization.
- The question of issuing shares to the employees and the public after a set period following privatization.

In addition to these, plans should be made to issue the shares of some internationally interesting SEEs like PETKİM in international markets.

LEGAL PROBLEMS

The Turkish Constitution contains no legal principles relating to privatization, and legislation on the subject unfortunately has serious deficiencies. The Privatization Act 3291, which was prepared outside the scope of traditional law making, fails to treat the subject comprehensively, incorporating amendments to certain provisions of the Central Bank Act, the Banks Act and the Capital Market Act, devoting only Articles 13-16 to provisions relating to privatization. Not only is it unwise to confine legislation on such an important issue as privatization to just four articles, but the provisions embodied in this act are too general and vague, and of inadequate scope.

It has become absolutely essential that Act 3291 be rescinded and a new privatization act drawn up to replace it. Statutory Instrument 233 and Act 2983 Concerning the Encouragement of Savings and Acceleration of Public Investment should also be revised accordingly.

As already said, Act 3291 contains no mention of, to whom the shares should be sold when privatizing state enterprises. Only Act 2983 and the PPA Regulations derived from it speak of sales to "real and legal persons".

Moreover, existing legislation relating to privatization contains contradictory statements about the decision-making and executive body and its functions.

The following principal bodies have been empowered to take decisions about privatization:

- The Economic Coordination Board (ECB),
- The Housing and Public Participation Administration (HPPA),
- The Cabinet of Ministers
- The Supreme Planning Board (SPB)
- The Public Participation Administration (PPA)

Act 2983, Statutory Instrument 233, Act 3291, Statutory Instrument 414 (which embodies amendments to Act 2953), and Act 3701-Concerning the State Planning Organisation-should be revised so as to resolve these contradictions concerning the identity of the body responsible for privatization. The new privatization act should state clearly and without ambiguity:

- The objectives of privatization,
- The methods to be employed,
- The order of priority for different buyers,
- The functions and structure of the bodies involved in privatization,
- The use of revenues raised from privatization.

EMPLOYMENT ISSUES ARISING FROM PRIVATIZATION

One criticism directed at privatization policy relates to the fate of SEE employees. Since there is over-employment, or to put it more accurately, hidden unemployment, in the state sector, it is likely that privatization will lead to redundancies. The liquidation of unproductive loss-making state corporations may result in even larger job losses. We consider that the following proposals should be taken into account in dealing with this aspect of privatization:

- 1) A special redundancy compensation scheme should be introduced for the employees of privatized companies, and legislation should include provisions aimed at reducing excess labor force under acceptable conditions. Although the establishment of a gratuity fund is envisaged under Labour Act 1475, the necessary legislation has never been drawn up.
- 2) An act permitting early retirement for those employed by privatized companies would also assist to reduce overemployment. It is vital, however, that precautions be taken to encourage skilled labour to remain.

3) An unemployment benefit scheme could also be introduced for employees of privatized companies.

A PRIVATIZATION ADVISORY COMMITTEE

In TÜSIAD's earlier report on privatization, the Association recommended that an Advisory Committee made up of representatives of diverse sectors (labour and employer unions, universities, the Stock Exchange etc) be established to act in an advisory capacity to the body responsible for privatization. Such a committee would make recommendations encompassing the views and proposals of the sectors represented, thereby also ensuring that privatization policy is not dominated by political considerations. A further proposal contained in this report is also worthy of consideration: "The individuals employed by the body responsible for privatization and members of the Advisory Committee should be banned for a specific period (10 years) from entering the employ of privatized companies, to ensure that they act impartially without any temptation to abuse their office." It is no secret that those previously or currently employed in the body responsible for privatization hold posts in SEEs as chairmen, directors and so on.

IS AUTONOMIZATION AN ALTERNATIVE TO PRIVATIZATION?

Fundamental to privatization policy is the conviction that the profit motive is stronger in private than in public enterprise, and that in consequence, the private sector is superior to the public sector in terms of efficiency and productivity. Whether this assumption is really true or not can only be determined by empirical studies. Here we should underscore the fact, however, that almost all existing empirical studies indicate that goods and services are produced more efficiently and at lower cost by the private sector.

Although the views that autonomization could be a means of eliminating political pressure and intervention in SEEs, and that the top-level management (general managers and directors) should be appointed with a minimum of government intervention have been advocated for many years by numerous individuals and institutions in literature on the subject, nothing whatsoever has been done in this direction. On the contrary, SEE management has become consistently more

politicized. General managers almost inevitably change with each new government, and the appointment of board members, auditors and advisors is motivated almost entirely by political considerations.

The management structures of SEEs are excessively centralised, and no progress has been made towards decentralization, which would allow the management of subsidiaries, affiliates or separate plants owned by SEEs to take their own decisions.

For these reasons **it would be wrong to view autonomization as a viable alternative to privatization.**

The prerequisite for improving the efficiency and productivity of state corporations is to eradicate political intervention in their pricing, production, investment and employment policies; in other words ensure their **autonomy. And the most effective method with the highest chance of success in bringing about this autonomy is privatization. Privatization should be regarded as an effective means of modernizing and rationalizing the SEEs in particular and the economy in general, and therefore as an essential element of policies designed to achieve these goals. So long as a far-reaching solution by means of privatization is not found to the problem of state corporations in Turkey, it will be impossible to attain a viable free market economy.**

Yet we have to accept the fact that there are some state corporations which can never be privatized, or whose privatization will take an extremely long time. In particular, those SEEs known as Public Economic Organisations, such as the Post Office (PTT), the Electricity Board (TEK) and the State Railways (TCDD), will be difficult to privatize entirely. What should be done about those corporations which it is not possible to privatize in the short term? We must look at what measures can be taken to improve their efficiency and productivity while remaining under state ownership.

The debate on rehabilitation, reorganization and autonomization of SEEs goes back to the 1930s. Each new government has declared its intention of solving the SEE issue, and numerous laws and regulations have been passed with this object, not to mention the many commissions, committees, and boards which have established in this connection. Yet despite all these, the SEE problem has remained unsolved.

Increasingly the state corporations have undermined the Turkish economy, exerting an adverse affect on Turkish industrial structure.

So what can be done?

The following recommendations for the revitalisation and rehabilitation of those SEEs which cannot be privatized or for which privatization will take a long time should be taken into consideration:

1) The first step should be to form a SEE Reorganization and Rehabilitation Board, consisting of members from the State Planning Organization, the Department of the Treasury and Foreign Trade, the Public Participation Administration, experts from the National Inspection Board whose work relates to state corporations, academicians, high-level SEE manager and a representative of TÜSİAD. The principal function of this board should be to define the problems facing the SEEs, to generate ideas for their solution, and to design a reorganisation model.

2) Successful revitalization and rehabilitation of SEEs depends on a well designed reorganization model. The SEKHOL model outlined below could be used to achieve reorganization.

3) Legislation should be passed to effect the integration of the SEEs with the free market economy within the framework of the revitalization and rehabilitation program. The SEEs should be at liberty to determine their own pricing, production, investment and employment policies, with a minimum government intervention.

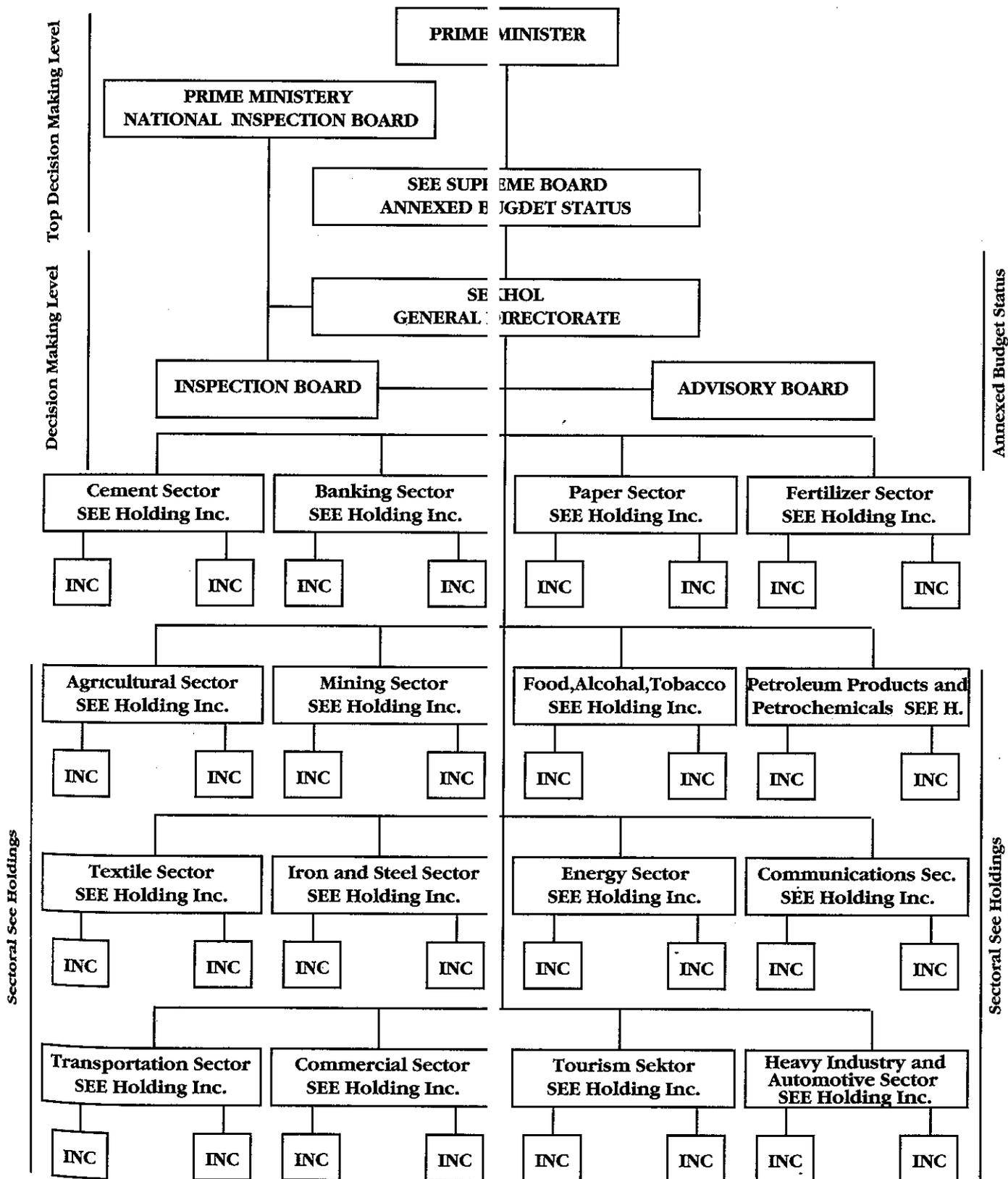
SECTORAL SEE HOLDING (SEKHOL) MODEL

What we have termed the Sectoral SEE Holding Model could replace the current organisational model as laid down in Statutory Instrument 233. The principles of this new reorganization model may be outlined as follows (See figure 1):

In the SEKHOL model a State Economic Enterprise is defined as a joint stock company, more than 50% of whose shares are owned by the state. It does not make the distinction between Economic State Organisations and Public Economic

Figure 1.

SEKTORAL SEE HOLDINGS (SEKHOL) MODEL



Organisations specified in Statutory Instrument 233, instead grouping all State Economic Enterprises by sector under "Sectoral SEE Holding Companies". Nor does the concept of Affiliate used in Statutory Instrument 233 appear in this model. Those related companies in which SEE have minority holdings of between 15% and 50% are referred to as **associated companies**, which accords with the same definition in the Statutory Instrument. The plants or factories belonging to the companies are not regarded as separate establishments as in the Statutory Instrument, but merely as the production units of the company.

Under the SEKHOL Model all the Sectoral SEE Holdings are directly under the Prime Minister's Office, and all powers of inspection and control currently invested in various ministries are abolished. Instead a **SEKHOL General Directorate** answerable directly to the prime minister is envisaged.

The highest decision-making organ in the model is the SEE Committee, whose responsibilities should be as follows:

- To determine principles and management policies for the productive and profitable operation of existing Sectoral SEE Holdings.
- To decide on the establishment of new joint stock companies affiliated to the SEE holdings in development priority regions,
- To decide on the privatization and or liquidation of existing Sectoral SEE Holdings.

SEKHOL General Directorate should operate as an annexed budget organization whose principal functions are as follows:

- To monitor the operations of Sectoral SEE Holdings and ensure their productivity and profitability,
- To ratify their annual programs, balance sheets and final accounts, and their annual general reports drawn up in compliance with their annual and long-term programs.
- To examine investment projects presented by the Sectoral SEE Holdings and

ratify them,

- To present the annual Inspection Report prepared by the Inspection Committee to the National Inspection Board,
- To decide what proportion of Sectoral SEE Holdings' profits should be payable to SEKHOL General Directorate,
- To take the necessary measures for the rehabilitation of loss-making and non-productive companies, to provide financial support and improve their financial structures.

As well as an **Inspection Committee**, SEKHOL General Directorate will comprise an **Advisory Committee**, employing a limited number of SEE experts with relevant qualifications.

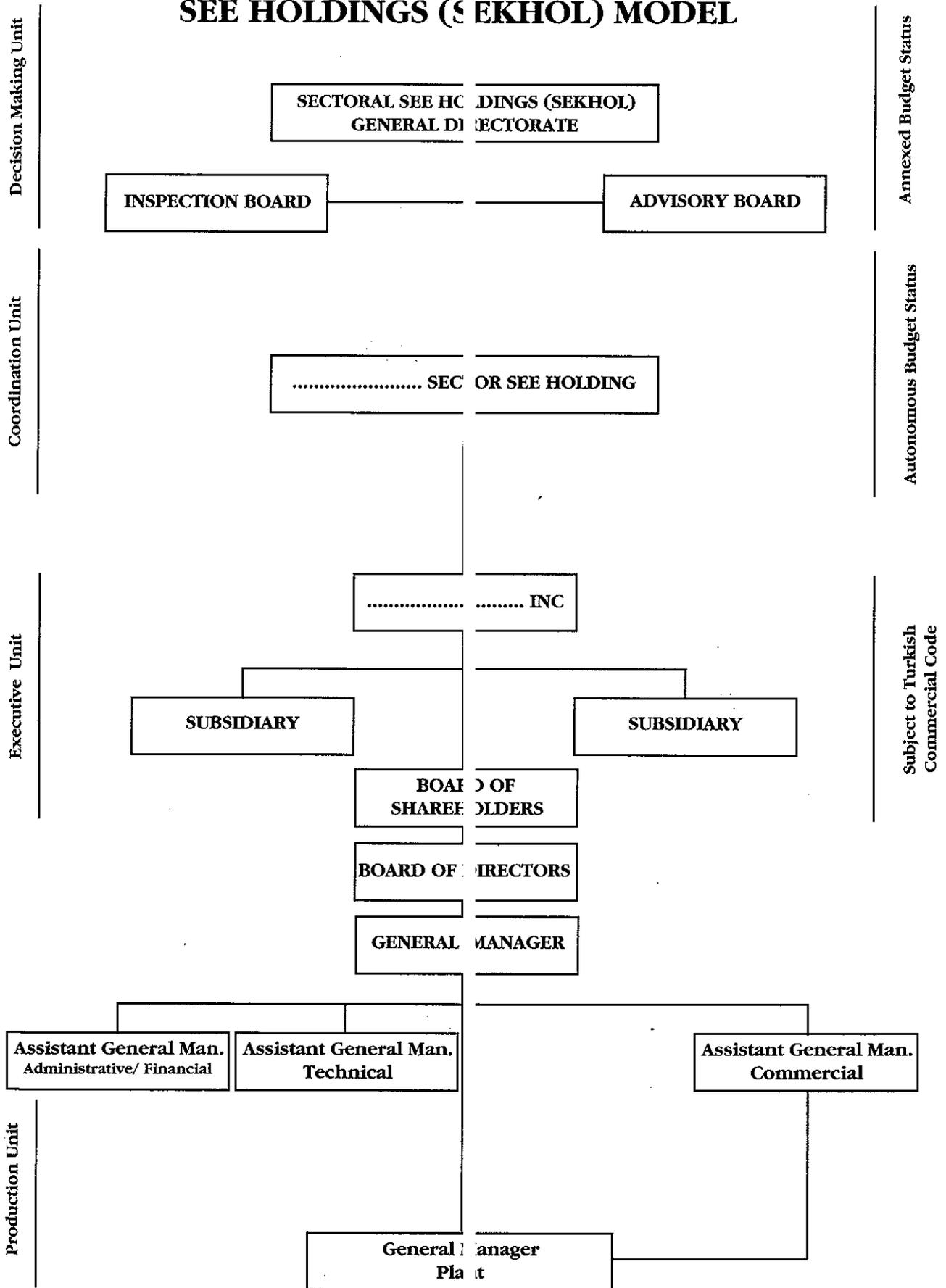
The Sectoral SEE Holdings will have autonomous budget status, and be fully liable to the provisions of the Turkish Commercial Code. Under the model, they are not subject to the General Accounting Act or the State Tenders Act, nor to inspection by the Council of Public Accounts. The administrative, financial and technical supervision of the Sectoral SEE Holdings is undertaken by the **SEKHOL Inspection Committee**, which reports to the National Inspection Board. The National Inspection Board does not merely approve the report of the SEKHOL Inspection Committee, but constantly monitors and inspects the Sectoral SEE Holdings itself.

Article 40 of Statutory Instrument 233 provides that the state corporations be supervised and inspected by the relevant ministry, but despite the provision in the final clause that this supervision and inspection "be conducted so as not to restrict the responsibilities and powers of the company itself, or obstruct its normal operations", the ministries have in fact exerted constant pressure and interference. The SEKHOL model will make the SEKHOL General Directorate, rather than the ministries responsible for the supervision and inspection of all Sectoral SEE Holdings.

The management structure of the SEKHOL model is shown in Figure 2. Each holding group is composed of joint stock companies, each with a board of directors

Figure 2.

ADMINISTRATIVE STRUCTURE OF THE SECTORAL SEE HOLDINGS (SEKHOL) MODEL



and a board of shareholders. The companies are entirely subject to the Turkish Commercial Code and in no way differentiated from private joint stock companies, being managed by a general manager in line with the decisions taken by the board of directors. Each general manager has three assistant general managers, responsible for administrative-financial, technical and commercial activities. Plants producing goods and services are under the control of the general manager and there is a factory manager reporting to the assistant general manager for commercial activities.

The SEEs can be classified into 16 sectors each forming a Sectoral SEE Holding. For instance the **Cement Sector SEE Holding** will include all state sector companies and plants engaged in the production or sale of cement, ÇİTOSAN being transformed into the sectoral holding company, and all other plants and operations organised as joint stock companies. The **Banking Sector SEE Holding** will comprise all state banks and insurance companies. To give a further example, the **Mining Sector SEE Holding** will include the Turkish Coal Board and the Turkish Coal Mining Operations, but only the oil exploration operations of Türkiye Petrolleri A.O. and the mining activities of Etibank. Etibank's banking operations, for instance, will become a separate company under the Banking Sector SEE Holding. The advantages of this model may be summarised as follows:

- Since all SEEs operating in a particular sector will belong to the same holding company, it will be easier to coordinate their operations, and solve their financial, production, management and other problems.
- Without interference from the ministries, all the Sectoral SEE Holdings will be able to pursue their activities with a greater degree of autonomy, answerable only to the SEKHOL General Directorate.
- Inspection will be more efficient and functional.
- Unproductive and unprofitable SEEs will be rehabilitated in readiness for privatization. In the case of companies for which rehabilitation appears impossible, they will be dealt with by **merging with** or **assimilation by** another group company, or liquidation.

- It will speed up and enhance the success of the privatization program. Instead of making public offerings of shares in unproductive and unprofitable SEEs, or quoting them on the stock market, it will be possible to sell the shares of all SEEs in the given sector. By this way the shares of a joint stock company could be sold as well as the shares of the parent holding company, encompassing the group as a whole. **However, the primary aim of the SEKHOL model will always be to rehabilitate the individual SEEs in readiness for privatization where possible.**

STATE LEADERSHIP IN UNDER DEVELOPED REGIONS AND SEE INVESTMENTS

There are several reasons for the state assuming the role of entrepreneur, principally among them the need to support and pioneer private enterprise. In regions or investments hampered by high risk factors or uncertainty, the state may take the lead as entrepreneur, or support private enterprise by providing infrastructure, technical assistance and financing. "Enterprise substitution" has been the foremost justification for the establishment of Turkey's state corporations. Investments with a low profit margin but high benefits in social terms which do not attract private enterprise, have been undertaken by the state. This is a particularly important function in economically backward regions, where SEEs have played a supportive and pioneering role for private enterprise.

In some regions of Turkey, this role remains a valid one. Despite the comprehensive incentive policy introduced in the 1980s, private sector investment in the country's eastern regions has still not attained the desired level. Although this is partly attributable to the failure to implement the incentive policy effectively, Turkey's underdeveloped regions are nevertheless an issue which must be faced squarely. In these regions the state is justified in investing in those sectors where private enterprise cannot be persuaded to invest despite all available incentives can be justified. Here the SEEs can engage in new investment, playing a pioneering role for private enterprise. Opportunities for joint ventures in these areas between private and state companies should also be investigated.

In cases where the privatization of existing SEEs in underdeveloped regions is feasible, public share offerings should be made first of all to employees and local

people, or the company transferred entirely to private buyers.

HOW TO PRIVATIZE LOSS-MAKING STATE ENTERPRISES

How to go about privatizing loss-making state enterprises is a critical issue. Some of the companies in question are gigantic in terms of their equity capital, constituting a serious obstacle to privatization. Finding buyers with the financial means to take them over will be extremely difficult, not to mention the undesirability of investing in a loss-making concern.

Some of the loss-making SEEs may be saleable once they have been rehabilitated under the SEKHOL model. An alternative to rehabilitation under state management could be the transfer of operating rights and/or leasing the companies to the private sector for rehabilitation.

Act 2983 provides for the transfer of operating rights. The PPF Regulations based on this statute define this process as the marketing and distribution of goods produced by SEEs and their subsidiaries for specific periods and under specific conditions in return for payment by real or legal persons. However, in the transfer of operating ownership rights being retained by the state, Article 11 of Act 2983 lays down a maximum limit of 15 years for such operating rights, but permits renewal of the agreement after this period expires.

The important point here is that incentive measures be taken to encourage the purchase of stock by employees of state enterprises and subsidiaries whose operating rights are to be sold. Transfer of operating rights is a rational model for the rehabilitation of loss-making state enterprises, and those who hold the operating rights may be given the option of later purchasing the concern on acceptable terms. Insufficient study has been made of this method and ways of ensuring its viability in Turkey.

Clearly no investor would be interested in purchasing a loss-making concern, nor would share issues be likely to find buyers on the stock market. For many years projects have been launched for the reorganisation of SEEs to improve their performance, but these have not been successfully implemented. Therefore, instead

of wasting time on repetition of such initiatives, the alternative method of transferring operating rights should be used to prepare these enterprises for privatization.

Leasing loss-making SEEs to real and legal persons under the Leasing Act 3226 is another alternative. This legislation was the first of its kind in Turkey, promulgated on 10 June 1985. Article 4 of the act defines leasing as "an agreement giving the lessee the right to use a piece of property purchased from a third party or otherwise obtained by the lessor at the request and choice of the lessee for a stated period on payment of a rental". It will not be possible to cancel the leasing agreement which is approved by notary before 4 years. A provision of the Leasing Act which is of particular importance with respect to privatization is laid down in Article 9, which states that while ownership of the property being leased remains with the lessor for the period of the agreement, the lessee may be given the option to purchase the property upon expiry of the leasing agreement.

PRIVATIZATION OF SEES NOT SUBJECT TO STATUTORY INSTRUMENT 233

Although the majority of state enterprises are subject to the provisions of Statutory Instrument 233, there are a number of exceptions, principally:

- Atatürk Orman Çiftliği
- Turkish Development Bank
- Ereğli Iron and Steel Factories
- İller Bankası
- Enterprises of which over 50% equity is owned by İller Bankası, provincial councils (İl Özel İdareleri), municipalities or a combination of these
- National Insurance Board
- Turkish Radio and Television Corporation
- National Lottery
- Bağ Kur

Of these, Turkish Development Bank and the Ereğli Iron and Steel Factories may be singled out as particularly conducive to privatization. Turkish Development Bank holds a large portfolio of interest in companies all over Turkey, many of them in development priority regions. These related companies, some of which are short-

financed but many profitable, should be privatized as soon as possible. The bank has already privatized some of its investment holdings, either by means of block sales (on or off the stock exchange) or by issues of shares to the general public. In addition to its own related companies, the bank is involved in the rehabilitation of private sector enterprises which have been left half-finished or had to close down due to lack of funds. At the same time the Bank uses **leasing** and **management buy-out** methods to prepare manufacturing enterprises for privatization. Although leasing is relatively new to Turkey, over the six years since it was introduced, the number of companies using this facility and the volume of leasing transactions have risen rapidly. Act 3226 allows for leasing to or from foreign countries as well as within Turkey. We believe that leasing could improve the financial structure of some of the SEEs subject to Statutory Instrument 233 and Turkish Development Bank subsidiaries in preparation for privatization.

Management buy-out involves placing a company to be privatized under the control of a professional management team. Once the company achieves a sound financial structure, the managers are awarded shares in the company and a proportion of the profits. Management buy-out agreements also give the management the option of outright purchase of the company once it begins making a profit if they so desire.

SUMMARY OF RECOMMENDATIONS CONCERNING PRIVATIZATION

In order to speed up and improve the chances of success of the privatization scheme, the following points should be taken into account:

1) Privatization implies far more than merely transferring ownership and management of the SEEs to the private sector. It is a vital tool for creating a true free market economy, and as such,

- Public goods and services should be provided by the private sector wherever possible. Incentives should be introduced to encourage private investment in services traditionally supplied by the state, such as education and health. Preparations should begin for the introduction of a coupon system for privatizing education and health services.

- Pricing of public goods is another aspect of privatization, since it is essential that public goods and services be subject to market mechanisms. As far as possible those who use these services should pay for them.
- The necessary legislation should be passed to allow privatization of forests. This entails amending Article 169 of the Constitution in which it states that, "ownership of state forests may not be transferred. State forests must be managed and administered by the state in accordance with the law". This article should be amended in line with Article 168 concerning the Exploration and Management of Natural Wealth and Resources, so that operating rights may be transferred to private real and legal persons for specific periods.
- The state should concentrate its investments in areas where there is no private sector activity; and in areas where the state has to take the lead, such as transportation, communications, energy and defence, incentives should be introduced to encourage private sector investment. In order to reduce regional discrepancies in development levels, the state should confine itself largely to involvement in the key industries mentioned above.
- While on the one hand the privatization scheme attempts to reduce the share of the public sector in the national economy, the extra-budgetary funds have created a "**shadow public sector**". This phenomenon must be dealt with by consolidating the extra-budgetary funds into the general budget in line with the classic budget principles of generality and unity. There still exists a host of such funds of diverse size and purpose, and apart from those serving vital functions (such as the Housing Fund, the Public Participation Fund, and the Defence Industry Support Fund) they should all be liquidated at the earliest opportunity.
- Deregulation and decontrol are two important elements of privatization policy. The existing body of legal and institutional controls should be pruned back to a minimum. In the course of deregulation, pricing must be fully liberalised. Freeing prices of production factors is the principal condition of a true market economy, and decontrol entails non-interference by the state in not only prices of goods and services, but also interest rates, exchange rates, rents, and wages. Price controls never benefit the consumer, but only weight the scales in favour of one group

against others.

- Instead of the state producing goods and services, it should subcontract them to the private sector either by tender or agreement. Notifications of tenders should be published in the national press as far as possible, to maximise competitiveness. Municipal services in particular should be privatized by means of tendering.

2) The primary objective of this report is to examine privatization in the narrow sense of "**selling State Economic Enterprises**". In this respect, the following recommendations should be taken into account.

- Privatization in Turkey has been directed principally at the political objective of closing the budget deficit. Instead its main objectives should be improving the viability of the free market economy, raising productivity and efficiency, or spreading industrial ownership over a broad base.

- The Public Participation Administration should be allowed to pursue the privatization scheme without political pressure and intervention, being fully empowered to take and implement decisions. Early elections in 1991 led to a suspension of the Administration's privatization activities.

- The Public Participation Administration should keep the public informed about the privatization programme, since only with public support can it succeed. A public relations department should be set up to provide comprehensive information about the scheme, withholding no aspects whatsoever.

- Privatization policy should take the social ramifications into account by offering shares on advantageous terms to company employees and managers, and small investors. The Employee Stock Ownership Plan used so successfully in the privatization of TELETAS should be applied to other companies. Not only does this method involve employees in management, so securing peaceful labour relations, but also raises productivity levels.

- SEE shares may also be sold to Turkish and foreign real and legal persons, to local inhabitants, and Turkish nationals working abroad. But the **order of priority** should

be (from highest to lowest): employees, local inhabitants, Turkish real and institutional investors, foreign investors. Obviously it is impossible to sell all the SEEs entirely to employees and local inhabitants, so to speed up privatization, shares should be offered not only to real and institutional investors but also to non-nationals.

- Block sales have undermined public confidence in privatization. Care should be taken to set more realistic prices for block sales, and experts from various organisations, such as the State Planning Organisation, the Treasury and universities, should be consulted when determining prices. Hurriedly concluded block sales could shake public confidence in the privatization program to an irretrievable degree. The ÇİTOSAN and USAŞ block sales were an unfortunate illustration of this.

- The inadequacy of the existing Privatization Act 3291 is such that it must be abolished entirely; and replaced by new legislation which states clearly and unambiguously the objectives, methods, order of priority in share sales, the functions and structure of the decision-making and executive body responsible for privatization, and how should the return on privatization be used.

- Since transferral of SEEs to the private sector or their liquidation will result in redundancies, a special Redundancy Compensation Fund should be established under the Labour Act 1415 for state enterprises being privatized.

- A **Privatization Advisory Board** consisting of representatives of the private sector, universities, Türk-İş Union Confederation, the Stock Exchange, the Treasury Department, the State Planning Organisation etc. should be established.

- Autonomization should not be viewed as a viable alternative to privatization. Autonomization should only be considered in the case of SEEs for which privatization is either impossible or will take an extremely long time. A **SEE Reorganization and Rehabilitation Board** should be established for reorganizing and rehabilitating companies of this sort and autonomizing their management. The board's members should comprise experts from the State Planning Organisation, the Undersecretariat for Treasury and Foreign Trade, the National Inspection Board and universities, top-level managers of some state corporations, and representatives of the

private sector.

The principal function of the board will be to identify the problems facing the SEEs, to generate ideas for their solution, and to develop a new reorganization model for state corporations. The implementation of the **SEKHOL (Sectoral SEE Holding) Model**, which has been described earlier in this report, will speed up the process of privatization.

- In the meantime, Statutory Instrument 233* should be brought in accordance with the new legislation on privatization. The necessary legislation should be passed to allow uniformity in application.

- SEEs which have been singled out for privatization, but then left for a long time without any action being taken, face various operational problems. The lack of clarity and limited powers of those responsible for preparing financial and investment programs, asset procurement and labour recruitment obstruct company operations. Therefore, only companies which can be privatized immediately should be included in the program, and responsibility for company activities not relating to privatization should be clearly allocated without delay.

- Operating rights for loss-making SEEs may be transferred to the private sector under Act 2983 as a means of preparing the companies for privatization. Means of leasing SEEs to the private sector under Act 3226 should also be investigated.

- It should be endeavoured to privatize those SEEs not subject to Statutory Instrument 233 (primarily Turkish Development Bank and Ereğli Iron and Steel Factory) without delay, and it may be possible to lease the related companies of Turkish Development Bank to the private sector.

* Turkish Development Bank is not subject to Statutory Instrument No.233, and should be brought within the scope of this legislation.