Chapter 4

PRIVATIZATION AS A STRATEGY OF RESTRUCTURING IN DEVELOPING ECONOMIES: THE CASE OF TURKEY

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Abstract

In the 1980’s, the discussions and applications of privatization which began in England are still going ahead increasingly for many developed and developing countries from the beginning of 1990. Recently, privatization turned into a strategy which is preferred by developing countries for solving major economic problems or which is imposed to these countries by international organizations. It seems that the discussions about this subject are going to maintain its importance for the next years.

In this chapter, it is aimed to construct policy suggestions about how to pass from power doctrine to welfare doctrine according to privatization applications considering threats and opportunities of globalization in developing countries. Moreover, in the scope of privatization policies, dynamics of transiting from populist-voluntarist economy management to economic democracy is going to be discussed and a regulation model which can be taken as a guide for policy-makers in developing countries is going to be created based on the case of Turkey. In short, new policy suggestions are tried to be developed relating to privatization applications.

Keywords: Turkey; Regulation; Privatization; Eco-Democratic Contract Approach

1. Introduction

One of the most significant economic phenomena in recent years has been the privatization of State-Owned Enterprises (SOEs) all over the world. Whether privatization actually leads to
the improvement of efficiency in developing economies has been the subject of significant research studies, both theoretical and empirical. Public share in the economy has considerably increased in almost all countries due to the influence of Keynes’s policies applied in the aftermath of the World War II. However, the Stagflation Crisis of the 1970s and the economic problems of this crisis have lead to the questioning of public’s role in the economy. These developments have brought about the idea of privatization policies in most of the countries/regions throughout the world in the last 25 years.

In the 1980’s, the discussions and practices of privatization which began in England are still going ahead increasingly for many developed and developing countries from the early 1990’s. Globalization process takes some opportunities and threats for countries together and this situation forces countries to look for new strategies and policies. In this process, it can be said that countries which control “technology revolution” act as monopolizing “power doctrine” for the name of “welfare doctrine”. In this conjecture new searches for “welfare doctrine” will be sustained and potential solutions will be suggested as long as the process of privatization has not yet been completed and turned into a significant threat for developing countries. The amount of support given to industrialization strategy by privatization policies for the economical reconstruction process initiated in Turkey in 1980s is still important for Turkey and this is true for other such countries.

At that point privatization policies started to be preferred as a strategic means for restructuring economies. In addition, the debates of privatization are still continuing and various theoretical and empirical studies are performed on the effects of privatization as a policy. It will be useful to note that the consensus reached at intellectual and scientific level has a tendency towards the free market and private property proponents. The main theme of this chapter is the idea that discussions on this issue will remain important in the next years.

Privatization has the differential effects depending on the economical development levels of countries. Privatization is considered as the leading policy for the developing countries to have a sustainable development. There are some problems in developing economies in the supply of necessary capital due to insufficient capital accumulation. These countries get some financial support from international financial institutions such as the IMF and the World Bank in the form of credit and fiscal support. These institutions provide their financial supports on condition that privatization policies are maintained by these countries in accordance with economical liberalization. As a result, privatization has come to be a strategy which is implemented by the developing countries to solve their basic economical problems and/or which is imposed by the international organizations to such countries.

There is a need to establish new models in order to achieve efficient resource allocation and fair income division in developing countries in the global competition process. The handling of SOEs’ with an Eco-Democratic Contract Model as it is suggested in this chapter may establish a guideline for the prevention of results of a pure free economy leading to wild capitalism and for transformation of certain challenges to certain opportunities. In this way SOEs may be restructured in a way to form the core point of a new industrialization in accordance with competitive regulation model. In short, when all the theses introduced in first part of this chapter defending SOEs’ goal function and the necessity of privatization are considered “The Second Best Theorem Based Welfare Model” may become an applicable one. The Eco-Democratic Contract Model, explained here, is taken from a hypothesis which suggests that privatization has its own rationales changing in compliance with national realities and that there are rationales describing nationalization (transforming into public
property) within the integrity of the same model. In this way a model, enabling establishment of mechanisms to restructure the choices of policy according to possible circumstances and combine nationalization and privatization rather than unilateral approaches pertinent to public enterprises property, has been established (Kök, 1995: 111, 209).

In this chapter, it is aimed to construct policy suggestions about how to pass from “power doctrine” to “welfare doctrine” in the context of privatization applications considering threats and opportunities of globalization in developing countries. Moreover, in the scope of privatization policies, dynamics of transitioning from populist-voluntarist economy management to economic democracy is going to be discussed and a regulation model which can be taken as a guide for policy-makers in developing countries is going to be created based on the case of Turkey. In short, new policy suggestions are developed in relation with privatization practices.

2. Economical Motivations of Privatization in Developing Economies

It can be said that the discussions on privatization will remain important in the next years when the privatization experiences in many developed and developing economies are considered. For this reason, the level of public consciousness about the main motivation and purposes of privatization is important for the implementation of effective policies particularly in developing economies.

International financial institutions such as the IMF and the World Bank started to provide financial credits to developing countries in 1970s. The risk of default in repayment of principal and interest of these credits from the early 1980s caused privatization practices to become widespread on the international platform. Special units were established within international financial institutions such as the IMF and the World Bank to spread privatization practices in order to reduce the influence of public share on economies of developing countries. As a result of activities of these units, some economic programs aiming to limit the statitism policies are put into practice in the member states for effective implementation of the IMF programs (Kök, 1995; Ghosh Banerjee and Rondinelli, 2003). In accordance with these programs, the fulfillment of duties by member countries has periodically been audited with “stand by” agreements and the countries that do their “homework” well are provided with financial support.

In the literature (Marchand et al., 1984; Ramanathan, 1986; Domberger and Piggott, 1986; Ramamurti, 1987; Perelman and Pestieau, 1988; Cremer et al., 1989; Zeckhauser and Horn, 1989; Vining and Boardman, 1992), the main objectives of SOEs in relation with the assessment of improvements in short and long term financial indicators of private enterprises are to:

- Sustain effective use of resources on the basis of coordination of economical activities and increase the competitive power of enterprises.
- Reduce income and wealth inequalities; obviate intra-regional instabilities, balance social inequalities by encouraging intra-regional development and ensuring justice.
- Create employment opportunities, provide income for state budget and maintain price stability.
- Back up skilled labour creation, improve employee wealth by improving working conditions and encourage employers’ participation.
- Provide the implementation of policies which encourage import substitution.
- Make basic infrastructure investments, improve social security and provide public facilities.
- Boost foreign trade, direct the currency gain to creative fields to reduce technological dependence and thereby create a self-sufficient economy.

In summary, the main goals of public enterprises are to realize the socio-economical aims for the welfare of society and maximize the net social benefit. But the main problem here is to determine how, to what extent, why the implementation results deviate from the desired goals, and how to specify objectives precisely at the beginning.

On the other hand, there are many studies pointing out the necessity of privatization and evaluating the results of it (Megginson et al., 1994; D’Souza and Megginson, 1999; Havrylyshyn and McGettigan, 1999; Djankov and Murrell, 2000, 2002; Megginson and Netter, 2001; Kök and Çoban, 2002; Boubakri et al., 2005; Çoban and Seçme, 2005). Accordingly, it is well understood that SOEs are less effective when compared to private owned enterprises (POEs) and there are some reasons for this. Some of these reasons are; multi-dimensional goals of SOEs, type of ownership, market structure, insufficient encouragements in the management of public enterprises and bureaucratical and political interests (Boardman and Vining, 1989; Vickers and Yarrow, 1991; Laffont and Tirole, 1993; Kök, 1995; Shleifer, 1998; Havrylyshyn and McGettigan, 1999; Nellis, 1999, 2000; Djankov and Murrell, 2000, 2002; Shirley and Walsh, 2000; Sheshinski and Lopez-Calva, 2003).

In the neo-classical economic theory, the relationship between ownership structure and the efficiency of resource allocation, which is described with approaches of public choice and property rights, is explained with the changes in the nature of ownership which causes differences in the efficiency between public and private sectors. “Public Choice and Property Rights Theory” makes specific reference to the hypothesis which suggests ownership change will create a greater economical surplus and resource allocation will even be improved. Private ownership therefore forms the core point of the notion of sustainable activity. Consequently, it is suggested that public enterprises cannot be as efficient as private enterprises because the necessary encouragement and rewarding mechanisms doesn’t work due to public ownership structure in SOEs. It is also important how and whereby the division was maintained in a specific period throughout history and the amount of effectiveness reached within that process.

One of the fundamental reasons of resource allocation inefficiency in Public Choice Approach is the bureaucratical structure with poor competitive conditions and auditing mechanisms which cannot be implemented in a direct way (Hayek, 1978). However, it is determined in some empirical studies on countries/sectors public enterprises that SOEs have a more efficient resource allocation. It can also be said that there is not a direct connection between the type of ownership and efficiency of resource allocation in the theoretical aspect (Saygılı ve Taymaz, 1996: 405–408; Barberis et al., 1996; Kole and Mulherin, 1997; Boubakri and Cosset, 1998, 2002; Lizal et al., 2001; Harper, 2002; Megginson et al., 2004).
On the other hand, the literature generally distinguishes two types of corporate governance mechanisms: internal and external. Internal mechanisms mainly include the organizational structure and the ownership structure of the firm, while the external mechanisms include capital market monitoring as well as the legal and institutional system. Boycko et al. (1996) developed a model to describe the relative inefficiency of SOEs and improve efficiency in the post-privatization period. According to this model, limiting state’s control on economy improves the performance of firms and thus, higher profits may be achieved. On the other hand, the performance of Newly Privatized Firms is directly influenced by the increase in the amount of foreign investors in the post-privatization period. This is so because foreign investors provide new funds for newly privatized firms, create new expansions for the introduction of companies and strictly audit the activities of managers. Therefore a positive relationship is thought to exist between foreign ownership and improvement of performance in the post-privatization period. Internal monitoring mechanism is rather related to organizational structure of the firm such as the administrative board and top executive. Insufficient performance of SOEs is generally associated with the poor quality of members and managers assigned by the government. Moreover, corporate governance and monitoring mechanisms cannot be established just because of unqualified managers in the developing economies, in which corporate governance mechanisms cannot be maintained effectively and goals almost not related with profit maximization are pursued.

One of the reasons for the relative inefficiency of SOEs in developing economies is the effect of market structure on resource allocation. Some economists relate the firms’ technical efficiency with competitive structure of the market and claim that it is impossible to sustain efficiency in a firm with a monopolistic structure. The sectors and firms aiming to obtain added value in global competition can increase their efficiency of resource allocation unless privatization brings about a monopolistic market structure (Kök, 1995: 22–27). The concept of dominant power has a crucial role in the explanation of public’s share in the economy. In monopolistic market structures which are formed in accordance with legal regulations, the concepts of dominant power and monopolistic power have the same meaning. Economic decision units (the economic agent) which has monopolistic power in its hands (agent) – if the dominant power is a state owned enterprise, the public-, becomes a firm imposing its own regulation rather than market regulation.

The dominant or monopolistic power concepts can prevent rival or potential rival firms from entering the market, force current rivals to leave the market and complicate the diffusion and exploitation of new technologies. Such strategies bring about some economical which reduce both the efficiency of resource allocation and competition (Estache, 2001: 100). The competitive structure should therefore be improved and anti-monopolistic laws should be put into force in order to prevent misuse of monopolistic power and formations, which will reduce the efficiency of market mechanism. The notion of regulation, which is one of the main recent concerns of economy literature and shaped in accordance with the “Regulation Theory” of Stigler, Posner and Peltzman, has been the main point of discussions on privatization especially in developing countries. This is so because regulation is used as a means of policy to improve competitive power in international market and efficiency of resource allocation (Kök and Çoban, 2002).

What is competitive power as a concept? It would be useful to handle this issue starting from the difference between developed and developing countries since it is of crucial importance. In particular, the concepts of global and national competition should be
considered at length and they should be associated with the notion of privatization in accordance with the meaning attached to them: as a matter of fact there are so many discussions in literature (Porter, 1990; Krugman, 1994; Reinert 1994; Siggel and Cockburn, 1995; Cockburn et al., 1999; Begg, 2002; Budd and Hirmis, 2004; Kitson et al., 2004; Henricsson et al., 2004; Banterle, 2005; Depperu and Cerrato, 2005). According to Haatoja and Okkonen (2004) the competitive advantage should be handled with a multidimensional approach. For example, criticizing the concept of national competitive power, Krugman (1994), suggests that this concept is a “monomania”. In his point of view domestic policies deviate from targets and international economical system is threatened by national competitive power. Krugman objects to the hypothesis that each country’s economical future will be determined by its success in the global market. That’s because, a country’s commerce in the world is something different from the competition among its firms. Unlike the firms, countries aren’t rivals to each other. If the term “competitive power” has a meaning, it should be explained in connection with relative productivity and competitive power at the global level. In fact each country’s competitive level should be determined in accordance with its domestic productivity increase rather than the relative productivity increase on the competitive scale. According to Krugman, policies for increasing national competitive power will be hidden in a “Mercantilism in a Lambskin Suit” since they will only result in such things as customs protection and commercial wars (Krugman, 1994; Begg, 2002).

Mc Fedridge (1995), does not support the idea that the economical performance of a country is something different from that of firms’. According to him competitive power is shaped in compliance with objectives pertinent to performance of national economy as well as economical objectives of public policies. That’s to say, competitive power and national competitive power concepts have the same meaning. On the other hand Krugman’s approach which is based on productivity corresponds to United Nations approach. According to this approach not only foreign trade but also investments, technological changes and improvements and thus the dynamic improvements in the human resources are considered when determining international competitive power. In short, Krugman suggests that it is necessary to analyze competitive power at the firm and industry level. This approach is supported by Porter (1990) as well. According to Reinert (1994), who represents an alternative approach, a nation’s efficiency and productivity in industrial and organizational level cannot be considered as a country’s welfare indicator. In other words, a country with a low competitive power may have high competitive power on the level of firm. When viewed from the neoclassical rhetoric, welfare may be improved because productivity will increase and prices will decrease in accordance with improvements in production technology. Here national competitive power, which is analyzed under the assumptions of complete information about market, constant return to scale and equalization of factor prices becomes insignificant.

In order for the global scale competitive power to be meaningful effective policies must be developed to keep additional factor incomes inside the country. The phenomenon of imperfect competition is in the background of global competitive power. The inequality in factor prices, which is defined with imperfect competition conditions, reduces national competitive power. In conclusion, the productivity and efficiency of national firms in the micro level doesn’t always mean that the national competitive power will increase. If technological developments reduce the product prices rather than increasing factor owners’ (in a settled country) income, welfare improvement resulting from cost reductions parallel
with productivity will be transferred to transnational consumers. Therefore national competitive power cannot be defined only with the increase in the productivity and efficiency of industry/firms.

Moreover, the relative level of national competitive power can be explained with the increase in productivity in most areas as well as policies including high quality activities resulting from information economies originated scale economies. In addition, it is necessary for the enhancement of global competitive power that national competitive power is increased. Therefore, it is of crucial importance that approaches for effective and productive use of all national resources and small scale applicable models are developed.

3. Privatization Experiences in Turkey and World

After the 1970’s the function of the state in the economy have started to be questioned in many countries. At that time airline and railway transportation services as well as telecommunication, postal services, electricity, and gas services were provided by public sector. Some politicians believed that the state should go on giving service in some “strategically” important areas.

3.1. Privatization Applications in the World

After the 1970’s the function of the state in the economy have started to be questioned in many countries. At that time airline and railway transportation services as well as telecommunication, postal services, electricity, and gas services were provided by public sector. Some politicians believed that the state should go on giving service in some “strategically” important areas.

While these discussions were going on, Thatcher government came into power in 1979 with a strong public support. Although the Thatcher government may not have launched an extensive privatization program, it adopted privatization as a major economic policy.

In the mean time, the Adenauer government in the Federal Republic of Germany launched the first large-scale, ideologically motivated "denationalization" program of the postwar era. In 1961, the German government sold a majority stake in Volkswagen in a public share offering heavily weighted in favor of small investors.

Margaret Thatcher adopted the concept of “privatization”, which was originally coined to literature by Peter Drucker, instead of “denationalization” (Yergin and Stanislaw, 1998: 114). Privatization policies were strenuously attacked by the labour opposition and some enterprises sold in that process were renationalized. It was not until the successful British Telecom initial public offering in November 1984 that privatization became established as a basic economic policy in the UK. Privatization practices have gained momentum after the mid 1980’s. A series of increasingly massive share issue privatizations during the last half of the 1980s and early 1990s reduced the role of SOEs in the British Economy to essentially nothing after the Tories left office in 1997, from more than 10 percent of GDP 18 years earlier. It’s crucial to note that the objectives set for the Thatcher government’s privatization program were virtually the same as those listed by the Adenauer government.
These goals, as described in Price Waterhouse (1989a, b), are to

- raise revenue for the state,
- promote economic efficiency,
- reduce government interference in the economy,
- promote wider share ownership,
- provide the opportunity to introduce competition and
- subject SOEs to market discipline.

The other major objective mentioned by the Thatcher government is to develop the domestic capital market by means of privatization policies directed by the government. The unexpected success of the British privatization program helped persuade many other industrialized countries to begin divesting SOEs through public share offerings. The public share in SOEs in these countries was offered to initial public offering.

Jacques Chirac’s government, which came to power in France in 1986, privatized 22 companies before being ousted in 1988. The returning Socialist government did not execute any further sales, but neither did it renationalize the divested firms. Beginning in 1993, the Balladur government launched a new and even larger French privatization program, which has continued under the Jospin administration. The Socialists, in fact, launched the two largest French privatizations ever, the $7.1 billion France Telecom initial public offering in October 1997 and the subsequent $10.5 billion seasoned France Telecom issue in November 1998 (Megginson and Netter, 2001).

Several other European governments, including Italy, Germany, and Spain, also launched large privatization programs during the 1990s. These programs typically relied on public share offerings; that’s the distribution of ownership to large public segments. The socialist governments didn’t object to privatization practices for they have such goals to realize.

Privatization spread to the Pacific Rim, beginning in the late 1980s. Japan has sold only a relative handful of SOEs during the past 15 years, but many of these have been truly enormous. For example the three Nippon Telegraph and Telephone share offerings executed between February 1987 and October 1988 raised almost $80 billion, and in only November 1987 a public offering of $40.3 billion has been made. That remains the largest single public offering in privatization history (Megginson and Netter, 2001).

Elsewhere in Asia, governments have taken an opportunistic approach to SOE divestment. They sold pieces of large companies when market conditions are attractive. In these countries the revenues of privatization were generally used in covering budget deficits. Furthermore economic crises that gripped the region during the late 1990s have resulted in a slow down in privatization practices.

The People’s Republic of China and India have taken important steps in privatization practices. The People’s Republic of China launched major economic reforms as well as liberalization program in the late 1970’s. These programs and reforms have enhanced the productivity of the Chinese economy. At first there have been numerous low scale privatizations, and there have been relatively few outright sales of SOEs, so the overall impact of privatization has been limited. In 1999 the government reaffirmed its commitment to privatizing the very largest state enterprises. Chinese SOEs were burdened with so many social welfare responsibilities and that the government will have difficulties in implementing a privatization program large enough to seriously undermine the state’s economic role.
Another Asian country with a special position is India. It adopted a major economic reform and liberalization program in 1991, after adopting a state-directed economic development model for the first 44 years of its independence (Bai et al., 1997; Lin et al., 1998; Lin, 2000).

Latin American countries have implemented large-scale privatization practices. Particularly Chile’s privatization program is remarkable. In 1990 Telefonos de Chile was privatized. In this practice of privatization they used Western capital markets and enterprise’s share was sold to U.S. investors. This practice opened an important pathway for developing countries.

Mexico’s, another Latin American country, privatization program was vast in scope. That country having an interventionist economic system has remarkably been successful at reducing the state’s role by means of privatization. In 1982 Mexican SOEs produced 14 percent of GDP, received net transfers and subsidies equal to 12.7 percent of GDP, and accounted for 38 percent of fixed capital investment. In accordance with privatization practices, the government had privatized 361 of its 1,200 SOEs and the need for subsidies had been virtually eliminated by June 1992 (La Porta and López-de-Silanes, 1999).

Several other countries in Latin America such as Bolivia and Brasil have also executed large divestment programs. For example, Bolivia’s innovative “capitalization” scheme has been widely acclaimed. However, the most important program in the region is Brazil’s. Given the size of Brazil’s economy and its privatization program, and the fact that the Cardoso government has been able to sell several very large SOEs in spite of significant political opposition, this country’s program is likely to remain very influential. Two of these enterprises are Companhia Vale Do Rio Doce and Telebras (Meggison and Netter, 2001).

Privatization in sub-Saharan Africa has been something of a stealth economic policy. Few governments have openly adopted an explicit SOE divestment strategy, but shows that there has been substantially more privatization in the region than is commonly believed. For example in Nigeria, divesting SOEs has been repeatedly put on the agenda but there have only been some small scale divestments (Jones et al., 1999). In short privatization practices weren’t successful in these countries.

The last major region to adopt privatization programs is comprised of the former Soviet-bloc countries of Central and Eastern Europe. These countries began divesting SOEs as part of a wider effort to transform themselves from command into market economies. Therefore, they faced the harsh repercussions and had a restricted set of policy choices. After the collapse of communism in 1989-91, all of the newly elected governments of the region were under pressure to create a market economy as quickly as possible. However, political considerations essentially required these governments to significantly limit foreign purchases of divested assets. Therefore governments preferred to launch “mass privatization” programs. In this divestment method shares of ownership are distributed to all citizens, usually for free or at a very low price. These programs resulted in a massive reduction of state ownership in the countries’ economies. Mass privatization methods was initially popular politically, it became unpopular in many countries such as Russia. The old elite and the new oligarchs have revested their properties by various methods. The net effects have been disappointing in some cases but have varied widely. In spite of all these disadvantages, governments in various regions have performed rapid and successful privatization practices and made great revenues by making the purchase of SOEs more appealing (Meggison and Netter, 2001).
Privatization revenues are of crucial importance in the assessment of privatization practices in developing economies. Privatization revenues in these countries are shown in the Figure-1 for the period between 1990-2005.

There was a privatization with a revenue amount of $12 billion in 1990 in developing countries and about $11 billion of this revenue came from Latin American and Caribbean counties. The revenue from the privatization in these countries gradually increased until 1997 and has reached to its peak with $65 billion in the same year. With the affect of Asia Crisis which occurred in 1997 there has been a decrease in the amount of privatization revenues after 1998. The revenue of privatization has gained momentum after 2003 and has reached to nearly $57 billion in 2005. While Latin American&Caribbean countries have obtained the highest revenues from privatization until 2000s, European and Middle Asian countries had higher amounts of revenues from privatization after that time (Figure-1).

The historical discussion suggests that state ownership and SOEs’ share in economy have been substantially reduced since 1979. The role of SOEs in the economies of high-income (industrialized) countries has declined significantly, from about 8.5 percent of GDP in 1984 to less than 6 percent in 1991. This ratio is now thought to be below 5 percent (Sheshinski and Lopez-Calva, 2003).

The low-income countries show an even more dramatic reduction in state ownership. From a high point of almost 16 percent of GDP, the average SOEs’ share of national output dropped to barely 7 percent in 1995. And it is now thought to be about 5 percent. The middle-income countries also experienced significant reductions in state ownership during the 1990s. Since the upper- and lower-middle-income groups include the transition economies of Central and Eastern Europe, this decline was expected given the extremely high beginning levels of state ownership (Megginson & Netter, 2001).
3.2. Privatization Practices in Turkey

In many developing countries public sector has been the provider of production services in industrial fields requiring a huge amount of initial investment, thus in industries involving a high level of fixed cost. The goods and services produced in such industries are provided to consumers as a state monopoly through SOEs. The reason behind the state monopoly in such markets is the natural monopoly. There are such other economical reasons as insufficient capital accumulation in private sectors, low infrastructure investments required for development, lack of collateral relations between state services and other sectors. In countries where product and services are provided by SOEs, the prices are determined either by the government or SOE governances in accordance with social objectives attached to them (Çakal, 1996: 15-17).

The status of SOEs, institutionalized with special emphasis in Turkey after the 1930’s, in economy has been an important discussion point since then. The idea that SOEs can’t utilize their resources as efficiently as private enterprises has become a point of manipulation because of the neo-liberalist policies after the 1980’s. Turkey’s economy has entered a period of restructuring after the stability program executed on Jan 24th 1980. IMF supported program has many similarities with "Orthodox Stability Program- Orthodox Adjustment Agreement", which was implemented in some of Latin American countries. Being theoretically established on the basis of Neo-liberal approach, this program has the main objective of finding solutions to short term external deficit. Thus, Turkey had to agree and cooperate with international financial institutions such as the IMF and the World Bank. The program includes the following objectives respectively:

- To implement a tight monetary and fiscal policy,
- To reduce inflation,
- To enhance momentum of development by activating idle capacities,
- To liberalize foreign trade, encourage foreign capital investments,
- To take required precautions for establishing interest and exchange rates in (liberal) competitive market.
- To prevent interruption on prices,
- To reduce and stabilize real wages
- To liberalize importation.

These goals are mainly oriented towards restricting state’s activity and reducing public intervention in economy. The first legal regulation about privatization in Turkey was made through February 29th 1984 dated and 2983 numbered legislation, which also established the corporate mechanism of privatization. In subsequent periods a number of arrangements were made to obviate the difficulties encountered in the realization of privatization objectives. As a result of these efforts, the principles, strategies, procedures, authorised agencies and problems regarding privatization are all set out in the Privatization Law No. 4046, dated November 27th 1994. Despite these legal regulations, a positive and efficient period couldn’t be achieved through privatization-oriented discussions and practices starting in 1980’s and intensifying by 1990’s. Political instability can be considered as an important reason for this problem. There have been 17 governmental (Cabinet) changes since 1980 and this reflects the nature of this political instability.
As it is mentioned above desired goals pertinent to privatization practices couldn’t be achieved in Turkey for various reasons. As seen in Figure-2 the revenue of the privatization between the period of 1985–1997 is only around $3.6 billion. In recent years the process of privatization has gained momentum with the influence of international financial institutions such as the IMF and the World Bank and privatization revenue for the period 2004–2007 has reached up to $22 billion.

Source: (TPA, 2007).

Figure 2. Privatization Revenues in Turkey, by Region, 1985–2007 ($US millions).

 Privatization practices in Turkey between 1985 and 2007 have been implemented in accordance with some methods such as block sale, asset sale, public offering, international offering, I.S.E. (Istanbul Stock Exchange) sale, incompleted asset sale and sales to investment funds. $30 billion revenue of this period has been obtained respectively from block sale %61, public offering %17, asset sale %16, ISE sale %4, and %2 from sales to investment funds respectively (TPA, 2007).

4. A SOE-Privatization Coordinated Regulation Approach: The Second Best Theorem Based Welfare Model

When dealing with global scale competitive power it becomes clear that multinational corporations representing firms and industries are considered as main decision makers; governments, national policy makers are undermined as secondary decision maker units. Thus global economic order lacks social content when compared with national economic order, global income distribution is impaired and Walras’s "ethical efficiency" concept loses its meaning. We tried to give brief information about the structure of SOEs, which have an important role in the development of countries including Turkey, and evaluate divesting system from public property to private ownership and mention the results of privatization practices. In global scale arguments for increasing competitive power of firms and industries
involve micro policies and arguments for increasing national competitive power involve macro policies. Macro references are considered poor as opposed to the micro ones in Krugman and Reinert’s competitive power definition. Below, we propose a regulation model which is a combination of the macro and micro policies to synthesize Krugman and Reinert’s approaches. The main objective of this chapter is to establish a model that will distinguish the factors that improve the national competitive power. This model, which considers efficiency criteria as a prerequisite; aims to realize public life quality and productivity rise simultaneously. Only then, the increase of international trade performance could be accepted as the dynamic for global competitive power and the sufficiency condition of our model may be fulfilled.

4.1. Privatization as a Means for Regulations

Privatization is a competition policy for providing firms of public property with sustainable regulation and competitive power as well as the establishment and enhancement of global competitive environment. It also involves restricting public regulation fields in favor of market and firms. The main point of privatization hypothesis is that public firms will not be able to obtain a sustainable regulation power which will provide them competitive superiority. Therefore SOEs will lack entrepreneurship, creativity, cooperation and adaptability to technological developments and will have structure that can’t bear bargaining power. The lack of regulation capability in public enterprises spontaneously limits the regulation fields of cooperating firms and prevents them from using their power optimally or makes it difficult for them to use their power. In this context privatization is very important not only for SOEs but also for other firms to optimize their regulation field and power (Kök and Çoban, 2002).

The importance of privatization changes according to four basic factors when considered from global competitive policies point of view. These are (Türkkan, 2001: 235):

- The bigger the proportionate share of SOEs in economy is, the greater importance of privatization in competitive policies will be.
- The lesser SOEs’ autonomy in decision making is and the greater SOEs’ dependence on public in profit use and loss compensation is, the greater the importance of privatization in competitive policies will be.
- The more the restriction on the existence of private sectors in SOEs’ activity field is, the greater the importance of privatization in competitive policies will be.
- The more appropriate the methods used and the objectives targeted in privatization for improving and enhancement of competitive environment is, the greater the importance of privatization in competitive policies will be.

The importance of privatization as a restructuring strategy and a global competition policy is of higher value for the first three factors above in developing countries such as Turkey. It becomes more important which objectives and methods will enhance the improvement of competitive environment and sustainable regulation and competitive power.
The implementation of regulation mechanism on SOEs has implicit and explicit objectives in accordance with some limitations. These objectives within the framework of regulation mechanism and competition strategies may be listed as below (Joskow, 1998: 206):

- The products and services produced by the monopolies must be supplied to consumers with a lower price by depending on the regulation. In order the mentioned policy to be effective the monopolies must be obviated and the barriers to market entry must be reduced (The rent extraction goal).
- The regulation mechanism must increase the quality of SOEs’ goods and services (The supply-side efficiency goal).
- The regulation must increase the attractiveness of SOEs’ goods and services through consumer’s eyes and the structure and level of prices for the services and goods must be lowered as compared with private sector (The demand-side efficiency goal).
- The investors must be provided with more appropriate conditions in accordance with the regulations and thus investments should be made more attractive. By this way not only will the existence of capital stock be maintained but also additional capital will be provided to sectors. This regulation procedure both increases the revenues of investments and reduces capital costs of firms (The capital attraction or firm viability goal).
- The regulation mechanism arranges income redistribution and ensures that general taxation and spending policies are implemented efficiently by regulating price pattern and price level for SOEs (The income redistribution goal).

It’s of crucial importance that regulation mechanism for national competition should be managed effectively in order to achieve the above mentioned goals. The difficulties and delays encountered in the process of privatization which is considered to be a strategy to enhance resource allocation efficiency and competitive power, show that it will be difficult to restrict public’s regulation field in favor of market and firms. For this reason it will be fruitful if acquired and practiced experiences are exploited in the privatization policies aiming to restrict the public’s own regulation field. The developments happening in Turkey show that public won’t be eager to restrict its own regulation and activity sphere without a serious internal and external pressure.

Briefly, in Turkey where privatization practices are turned into a deadlock, the decisions and plans pertinent to public goods have been transformed into bureaucratic choice because of unstable democratic structure which restricts the participation of social groups. Therefore, bureaucracy is the institutional reason for undermining effective competition and productivity phenomena by obtaining an attractive and special position in decisions and plans pertinent to public goods. Inefficiency in resource allocation increases instability thus giving rise to misconducts in employment and government job sharing and as a result “bad administration in mismanaged democracies drives out good managements”. If we think that economy policy regulations are themselves public good because of the emerging vicious circle, the importance of creating a competitive regulation model for public goods will increase (Kök, 1995: 173–175). A theoretical framework for the development of a regulation model will be outlined in the next section acting from the case of Turkey to the attention of developing countries.
4.2. A Welfare Model Based on the Second Best Theory: Eco-democratic Contract Approach

The main objective of economic theory is to analyze the harmony mechanism based on safety and production-division which explains how a “satisfactory welfare level” will be achieved with limited possibilities. The concept of harmony, which forms the core point of Eco-Democratic Contract analysis, stands for the collaboration between individuals’ benefits and the basic requirements of society and the state which represents the society. Here the dynamic efficiency scale is taken as a reference point. The economic decision units, who are the real owners of national resources, should believe that there exists a safety based model for distribution and should have the power to test this belief in accordance with the political process as they are the representatives of the decision making authority. This will enable the benefit of factor endowments and production to be analyzed with a sustainable equilibrium. In this context, A Regulation Approach Based on SOE-Privatization Cooperation may be developed in accordance with the basic function of SOEs to generate net social benefit and the main objective of private enterprises to obtain maximum profit. According to this approach;

Private Enterprises’ Objective Function:

\[ \text{Max. Profit} = \text{Total Revenue} - \text{Total Cost} \]

SOEs’ Objective Function:

\[ \text{Max. Net Social Benefit} = \text{Total Revenue} - \text{Total Cost} \pm \text{Externalities} + \text{Consumer Surplus} \]

It will be beneficial to focus primarily on the scope of ±externalities and to briefly discuss this concept. “Externality is known as positive or negative impact of an economic agent (an individual or a firm) on another agent’s production, revenue, free time, assets or welfare”. A.C. Pigou has been the first economist to focus systematically on externalities in 1912. According to Pigou, considering negative externalities, Pareto-type (Type I) welfare cannot be maximized even in perfect competition markets. Let’s think of an economy with two consumers and two commodities in which the efficiency requisite in exchange is fulfilled. According to this, effective allocation may be explained as a position in which no individual can be made better off without another being made worse off. This may be considered for a situation in which the products are reallocated among the individuals upon conclusion of a trade having advantages for both sides.

As long as externalities aren’t taken into account and each individuals’ satisfaction are up to his own choice each competitive equilibrium such as hypothetically described W0, W1,… Wm and detailed in the below Figure-3 are accepted as a Pareto optimal allocation process. In this restricted figurative economy, if the income distribution among the consumers were worsened (actual circumstances) and if the government were to intervene (in accordance with eco-democratic contract approach) in initial hardware to enhance a fair income distribution; the market would reach an equilibrium (for example in graphic W’2 with a minimizable deviation) itself in a point far from the competitive equilibrium points. This situation is described as the “second theorem of welfare economics” (Ruffin, 1992).
Imagine that this intervention is performed in a way to have an impact on supply-side factor endowment in economy. Therefore, it is possible to divert supply-side resources from private sector to public sectors or vice versa. In 1960’s Ronald Coase pointed to the importance of having a retrospective outlook on history claiming that administration costs would exceed the revenue of eliminating economical inefficiency while, on the other hand, implied consent on Pigou’s thesis, who said social welfare would be improved as a result of state’s effective policies. If Coase’s approach could be turned into a competitive regulation model; that’s to say if the state basically removes uncertainty from competition by endorsing its property rights about the production of special welfare goods to private sector, efficiency might be achieved by minimizing state intervention and negative externality disorder might be resolved. For example, when there is a negative externality, optimal condition may be achieved by laying an appropriate tax on the production factor creating negativity or on the final product or an employment policy which resets populism in recruiting human resources may be lawfully legalized. The amount of tax laid must be minimally proportional to monetary value (social cost) negative externality. The employment policy must be transformed into a norm maximizing technical progress. In addition, positive externalities are perceived as a phenomenon which targets net social benefit since their revenues are in the form of subvention.

Because SOEs’ main goal in trying to maximize net social benefit (NSB) also increases the operatability of economic models which take Pareto’s the second best theorem as reference point. The four basic objectives which entail the emergence of SOEs and which reflect political, social and economical aspects may be achieved if the objective function appropriate to the essence of SOEs and the imperfect competition provisory and gradually monopolizing objective function of competitive private sectors are observed together and handled in a way that covers NSB>SOE Profit<Monopolistic Profit constraint. By this way, it may also be possible to prevent the failure of market mechanism which operates with a SOE-Privatization Combined Regulation Approach, enhance stability, divert the structure of income distribution towards large public communities. Consequently, a constitutional process, which is based on the main principles and which is established through the participatory collaboration of individuals who make decision, may be initiated.

The Second Best Theorem Based Welfare Model may be remodeled as a general model for developing economies based on the case of Turkey and may be listed under the following headings when discussed as an Eco-Democratic Contract Approach. These are to:

- Eliminate the privileges of some sections of the society,
- Minimize unfair competition and establish fair competition conditions,
- Pay special attention to stability and productivity based distribution by the state,
- Prevent voluntary and populist resource allocation by the state when fulfilling its main functions, in other words activating productive resource allocation.

In order for the state to develop a regulation model in accordance with the above mentioned factors, a social benefit-cost analysis must be performed through a “National Performance Assessment Centre”. This necessity may be explained with the Walras (1860) principal. The need to evaluate liberalism, which increases production and welfare, and evidences of socialist doctrine, which analysis the direction of improving welfare, and to generate new approaches from that evaluation still remains important. Therefore economists
must attach importance to “human efficiency”, which is based on the combination of “scientific efficiency” and “ethical efficiency” (Kök, 1999: 209).

A new regulation model is suggested below considering the above mentioned apprehensions and the privatization goals, economical, social, political motivations and methods of privatization which are already known in the literature. The difficulties encountered in decision making and coordination structure pertinent to public goods and various circumstances whose functional operatability is discussed in Turkish economic system. For example, while planning and decision making process of public good is generally maintained in accordance with the structure of the state, political system and legal regulations, this is not true for Turkey. The main reason for this is the inefficient or lacking regulations in corporeal content and actual practices of the current parliamentary system, which does not play any real role in regulating or monitoring the SOEs. This prevents the occurrence of free and flexible demands for public goods. On the other hand, the production, decision and preferences in relation with public goods are not only specified in accordance with political and administrative decisions but also far from the principle of rationality. There seems to be arbitrariness in political and administrative decision making processes in Turkey because the quality of rational and planned behavior is not well settled off in the minds of people. The principle of rationality in decision making and planning processes of public goods must be observed particularly in the commitments made during the political elections and alternative preferences policy must be put to vote and implemented. In current economic order an ineffective system of production and distribution of public goods is dominant. Such a system may be seen more in developing countries for this reason. The supporters of global competition use this as an argument on privatization.

Basic Assumptions of Model and Dynamic Efficiency:

The five basic assumptions for the analysis of dynamic efficiency in the model are:

1. Political liberalism and power doctrine experiences resulting from it are inefficient in fulfilling promised satisfactory welfare level.
2. Economies of scope resulting from global competition realize monopolizing process.
3. Human as an economic decision unit is not only homo economicus, but also homosociologicus in his decisions on supply and demand.
4. Public and private welfare goods both complement and substitute for each other in supply, production and marketing processes.
5. Economical efficiency, which is the major dynamic of welfare economy, is a basic scale for the Second Best Theorem Based Eco-Democratic Contract, which the reference point of resource allocation. This scale is used as a reference indicator for the proper implementation of the model by “Performance Assessment Centre” of each country.

In accordance with the above mentioned assumptions it is necessary to define the mechanism of The Second Best Based Welfare Model embodying the SOE-Privatization Combination.

The concept of "Dynamic Efficiency" may be manifested in Cartesian frame in the following way: Let’s suppose that general efficiency level of economic decision units may be determined within specific periods (year, 20 years) and let’s associate a country’s production structure with the production function of a multi-product firm or industry (agriculture, automotive, rubber industry etc.); as it is shown in Figure-3, let’s think that private welfare
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According to this, a nation, has the capital and labour stock by which it can produce both
\[
\sum_{i=1}^{m} X_i, X_2, \ldots, X_m = \sum_{i=1}^{m} X ; \quad \text{and} \quad \sum_{i=1}^{m} Y_1, Y_2, \ldots, Y_m = \sum_{i=1}^{m} Y
\]
goods in the length of coordinate axes. Let’s give W0 to the equilibrium on the “Eco-Democratic Contract Curve” in accordance with Pareto’s first welfare theorem (fundamental theorems of welfare economics) and data production factors shown in Figure-3 (W0, W1, \ldots, Wm equilibrium hypothesis in hypothetical exchange). According to this, the welfare level corresponding to any point in Cartesian coordinate system will display each of WP and WPr goods combination which can be produced using a nation’s capital stock. For example M0, M2, M4, M6, M10 refer to indifference curves group, WP refers to origin convex curves; and m1, m3, m5, m7, m9 indifference curves refer to convex curves to WPr origin.

According to Orthodox Standard Economic Theory, indifference curves under perfect competition conditions, \(MRTS_{\left(\frac{X_{\text{Pr}}}{W}, \frac{L}{K}, \frac{P}{P} \right)} = MRTS_{\left(\frac{Y_{\text{Pr}}}{W}, \frac{L}{K}, \frac{P}{P} \right)} \) is fulfilled when it’s equilibrium on welfare transformation curve (Eco–Democratic Contract Curves) is seen. The condition in which producer equilibrium and consumer (A, B) equilibrium \( \left( MRS_{\left(\frac{X_{\text{Pr}}}{W}, \frac{L}{K}, \frac{P}{P} \right)} = MRS_{\left(\frac{Y_{\text{Pr}}}{W}, \frac{L}{K}, \frac{P}{P} \right)} \right) \) is fulfilled correspondingly \( \left( MRTS_{\left(\frac{X_{\text{Pr}}}{W}, \frac{L}{K}, \frac{P}{P} \right)} = MRTS_{\left(\frac{Y_{\text{Pr}}}{W}, \frac{L}{K}, \frac{P}{P} \right)} \right) \) is known as the Micro General Equilibrium. In fact, the hypothetical equilibrium, which is a combination of production function emerging within the framework of econometric model, is not \( W_{0} \), it may be \( W'_{0} \) (error term: \( \varepsilon \) is included in the model). If we turn back to above named model; The Welfare Model based on The Second Best Theorem which is predicated on the idea that SOE and private sector factor endowments is reallocated in accordance with privatization process; may be explained with accessible potential equilibrium \( W_{3} \) according to Eco-Democratic Contract Approach. The model shown here, is the discussion about to what extent it would be possible to privatize the capital accumulation connected with SOE in order for the public to reach “satisfactory welfare” level. When the analysis pertinent to Pareto Type I ideal equilibrium shown in Figure-3 as \( W_{0} \) (\( W_{1}, \ldots, W_{m} \)) (The first theorem of welfare economics) and Pareto Type II deviated economic equilibrium shown as \( W'_{3} \), which is handled from the econometric point of view, (second theorem of welfare economics) are considered together we can reach to \( W'_{3} \) with a regulation modeling from the \( W_{0} \) equilibrium point, which emerged with a dynamic efficiency scale at first. Here the main expectation is not only the verification of the second best theorem, but also the minimization of inefficiency in \( W_{3} \) equilibrium process which is accepted as empirical equilibrium point as a substitute for hypothetic efficiency. Thus, the Eco-Democratic Contract Approach pertinent to production, division or consumption of private and public welfare goods accepts that the real equilibrium is within the band region specified by dynamic process. One of the main reasons of this inefficiency is the inability to control some of the variables which cause externality. Hypothetical equilibrium process of the
standard theory cannot be interrogated since these ambiguities, which can be explained mainly with information economies and land rents, aren’t included in the model. However, this ambiguities vector may be included in the model in compliance with developments in mathematical statistics. The second reason is the political choices which cause wrong resource allocations (Privatization rationality). For that reason the models which don’t include externalities in public production area and internalities in the private production area aren’t applicable. In this context, A Regulation Approach representing SOE-Privatization Combination which combines the above mentioned satisfactory welfare model of production and net social benefit function eliminates the instability generated by the concept of global scale monopolizing and this necessitates that the goal function is redefined (Kök, 1995: 175).

Another main objective of the model is to state that it is impossible for the nations to neglect division-safety component. Therefore, the rationale for intervention to privatization may sometimes conflict or overlap with the rationale for intervention to nationalization. In this context, this paradox must be resolved in the dynamic equilibrium process. In this case, a model based on satisfactory welfare rather than welfare maximization as introduced in Traditional Economy Theory must be established. Here privatization procedure must transform capital accumulation model into efficiency production model correspondingly with basic phases of general socio-economic development process. For this reason it is of paramount importance that a model based on production, division and safety is developed because the monopolistic structure, a probable consequence of pure efficiency hypothesis, may threaten the social reconciliation. The greatest advantage of this model is that it places the dynamic efficiency at the focal point of welfare transfer mechanism (Kök, 1995: 131).

Therefore, it will be necessary to minimize the gap between “actual equilibrium” (including all positive and negative deviations) and “ideal equilibrium” targeted in perfect competition and welfare maximization. This equilibrium must be in such an acceptable level that; the welfare level achieved by both private welfare goods (WPr), and public welfare goods (WP) may be simultaneously defined. This analytic approach, may be verified both with mathematical statistics method and “satisfactory welfare combination” (eco-democratic contract approach) which exist in coordinate plane.

In short, “satisfactory welfare” level of both group of goods (such as $W0, W0'; W1, W1'; W2, W2'; W3, W3'; W4, W4$') will rise proportional to the level of increase in their general efficiency level in the dimensions of time, place and factor. According to this approach, which is explained with simple arithmetical notations, the welfare resulting from production of private-welfare goods and the welfare created by production of public-welfare goods may be shown on Eco-Democratic Contract Curve.

Goal Function:

\[
WTE = \left[ \sum_{i=1}^{m} X_i \right] + \left[ \sum_{i=1}^{m} Y_i \right]
\]

\[
WTE = \alpha_1 + \beta_1 X_{Pr1} + \beta_2 X_{Pr2} + \beta_3 X_{Pr3} + \ldots + \beta_m X_{Prm} + \alpha_2 + \gamma_1 X_{P1} + \gamma_2 X_{P2} + \gamma_3 X_{P3} + \ldots + \gamma_m X_{Pm} + Ut
\]

In the above equation;
WTE: Expected satisfactory total welfare,
WPr: Welfare of private welfare goods production,
WP: Welfare of public welfare goods production,

Constraint function: XPr1, XPr2, XPr3, ..., XPrm: Private welfare goods and factor endowment generated by accumulative capital stock in the dimension of time and other production factors;

XP1, XP2, XP3, ..., XPM: Public welfare goods generated by accumulative capital stock in the dimension of time and other production factors,

β1, β2, β3, ..., βm: Input flexibilities obtained from private welfare goods production function,

γ1, γ2, γ3, ..., γm: Input flexibilities obtained from public welfare goods production function,

α1: Technical efficiency parameter of production function to private welfare goods,

α2: Technical efficiency parameter of production function to public welfare goods,

Ut: error term added to production function of each industry

According to this, WTE = WPr + WP "satisfactory welfare combinations" may be specified in Eco-Democratic Contract Curve. In fact this equilibrium is similar with the general equilibrium in micro economic theory.

As shown in Figure-3, individual welfare and national competition is related with sustainable production of both private and public goods and factor income sharing. The general equilibrium, which simultaneously maintains production and consumption efficiency of both private and public goods, may be defined with the success of a Regulation Approach with SOE-Privatization Combination which is established in accordance with political choices.

5. Result and Suggestions

There is a need to establish new models in order to achieve efficient resources allocation and fair income division in developing countries in the global competition process. The handling of SOEs’ with an Eco-Democratic Contract Model as it is suggested in this chapter may
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establish a guideline for the prevention of results of a pure free economy leading a wild capitalism and of transformation of certain challenges to certain opportunities.

Uneasiness of citizens in developing countries’ may be retrenched with such an approach. Likewise, the anxiety formed by inward-oriented national economy policies may be avoided. By this model it will be possible to avoid public doubt about foreign capital and block foreign capital’s aim of transnational hegemony formation. On the other hand, it will be crucial for the right questioning of utopical tendency of few multinational firms to establish a single world state, which is “policeman of the world”.

Economists’ search for such economic models may enhance scientific search programs because they will enable them to explain new global conditions with new paradigms. Because the main economic model for the states representing power is not the model which describes how global factor endowments have been monopolized. These are the models which describe the ways by which the inequality/poorness resulting from the allocation of limited global resources in a unipolar capitalism process can be prevented. It is clear that there is a necessity for such models. We can say that it is urgent that long-term renewable production and consumption circulation is maintained and even an Eco-Democratic Contract system, covering man and social reconciliation, is established.

In conclusion, the main goal of Eco-Democratic Contract model, which is established for empowering national industry, is to explain the dynamics for achieving global competition power on condition that national competition power is maintained. If this model is put into practice, it will be possible to overcome the artificial difficulties encountered in some stages of national development process, to internalize information economies, to develop a method of persuasion enabling us to use domestic savings to overcome capital insufficiency and to create a dynamic force which will enable national economy to take place in global competition, as well.

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