OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as "developed", "industrialized" and "developing" are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

FAIR USE POLICY

Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

19962

İSO

ISTANBUL CHAMBER OF INDUSTRY

INTERNATIONAL CONFERENCE

19 - 20 November 1992

COMPETITION POLICIES FOR TURKEY

Policies Affecting Domestic Competition and International Competitiveness:
An Evaluation and Agenda for Action

SUMMARY OF DRAFT PAPERS*

Refik Erzan
Editor

Project sponsored by
The Ford Foundation, NewYork
UNIDO, Vienna
- with contributions from
The World Bank economists, Washington

Conference sponsor and host
Istanbul Chamber of Industry

İSO Odakule Congress Hall

* The findings, interpretations and conclusions are the authors' own, and should not be attributed to the Ford Foundation, the World Bank, UNIDO or Istanbul Chamber of Industry.

CONTENTS

Acknowledgements

I. **Introduction by the Project Manager and Editor**
Assoc. Prof. Dr. Refik Erzan, Boğaziçi University,
Dept. of Economics / Senior Economist, World Bank

II. **Trade Liberalization, Competitiveness and Industrial Policy: Conceptual Issues**
Prof. Dr. Dani Rodrik, Columbia University and NBER

III. **The Impact of Trade Liberalization in Turkey: An Empirical Assessment**
Prof. Dr. Nazım Engin and Assoc. Prof. Dr. Erol Katırcıoğlu,
Marmara University, Dept. of Economics

IV. **Liberalization and Competition in Turkish Financial Markets**
Cevdet Denizer, Economist, World Bank

V. **The Role of Subsidies in Turkey**
Assoc. Prof. Dr. Refik Erzan, Boğaziçi University
Dept. of Economics / Senior Economist, World Bank

VI. **Restructuring and Exit Policies in Turkey**
Dr. Izak Atıyas, Economist, World Bank

VII. **Competition Law and its Relevance for Turkey**
Dr. Mark Dutz, Economist, World Bank

VIII. **Antidumping and Antisubsidy Policies in the Turkish Context**
Prof. Dr. Patrick Messerlin, Institut d'Etudes Politiques de Paris

IX. **Conditions of Competition and Determinants of Competitiveness: Theoretical Constructs versus Empirical Evidence**
Dr. Helmut Forstner, Economist, UNIDO

X. **The International Setting**
Dr. Patrick Low, Senior Economist, World Bank

XI. **The "New" Trade Theories and New Trading Opportunities for Turkey**
Dr. Raed Safadi, Economist, World Bank

XII. **What are the Policy Priorities?**
Assoc. Prof. Dr. Refik Erzan, Boğaziçi University,
Dept. of Economics / Senior Economist, World Bank

Acknowledgements

Selling an idea is not always easy, especially if you are asking money for it. On this occasion, it was possible because Seamus O'Cleireacain (NY) and David Nygaard (Cairo) of the Ford Foundation, Robert Ballance of UNIDO, and Memduh Hacioglu and Haluk Kabaalioglu of ISO thought that I had a good idea.

Carl Dahlman, Ronald Duncan and Tanju Yurukoglu of the World Bank allowed economists from their divisions to participate in the project.

The authors trusted my judgement and devoted their valuable time.

Ates Akinci extended his expertise in the interpretation of legal texts. My research assistants from Bogazici University, Ahmet Cimenoglu, Can Erbil, Nezih Guner and Zeynep Sarlak made important contributions to all the papers, and gracefully put up with me.

The Central Bank tested our hypotheses using their data base. Officials of the State Institute of Statistics, State Planning Organization and the Undersecretariat of Treasury and Foreign Trade provided insights and statistics.

Nese Ozturk of ISO gave organizational assistance.

Without such support, scholarship and excellent help, this project and conference would have been just another good idea.

I am grateful to all.

Refik Erzan
November 1992

I. INTRODUCTION

Refik Erzan
Bogazici University / The World Bank

Today, the business community, politicians, and most importantly the consumers talk about the need for greater competition in Turkish economy. It is ironic that this was unheard of about ten years ago, when imports were strictly regulated and almost no consumer goods were allowed into the country. Not surprising though. The economics profession also discovered very late that gains from trade through increased competition were quite comparable in magnitude to the gains from better sectoral allocation of resources along the lines of (conventional) comparative advantage. With this new focus, we realize that an outward (or export) oriented strategy works well, not only because it improves allocative efficiency, but as importantly, due to greater efficiency at the industry and firm level, induced by international competition. We call this "productive efficiency".

Few question, nowadays, the merits of an outward oriented strategy. However, (i) the extent of the "market discipline" effect of imports on competition; (ii) the desirable level of liberalization (or protection); (iii) the need for competition policies other than a liberal trade regime, in particular competition law; (iv) whether or not there should be an industrial strategy, and what that should entail; and (v) more generally, the role that government should play, are heatedly debated issues worldwide. "Competition Policies for Turkey" deals with these questions in the Turkish context.

What makes the Turkish case special is that none of the questions above are settled in Turkey - unlike most OECD countries which are committed to a generally liberal trade regime, which have a competition law, and persue active

competition policies.

On the question of industrial policy, however, Turkey is not alone in its search. Scared of totally losing their competitive edge to Japan and the newly industrialized countries (NICs) in manufactures, both Europe and the US are in a soul searching process.

Our study starts with a review of the ingredients of successful industrialization. Is outward orientation incompatible with a strategy of industrialization? What type of a strategy would that be? What role trade policy should play? Dani Rodrik examines what the "old" and "new" theories tell us on these questions, and what we learn from the East Asian Experience.

Nazim Engin and Erol Katircioglu try to assess empirically the impact of trade liberalization in the 1980s on the degree of competition in Turkish manufacturing industry - the hypothesis known as "imports-as-market discipline". Cevdet Denizer studies the effects of financial liberalization on the extent of competition in Turkish banking. I try to examine the pattern and role of subsidies in industry, and scrutinize the current debate on industrial policy in Turkey. Izak Atiyas evaluates restructuring and exit policies in Turkey, and discusses the alternatives. Mark Dutz reviews the arguments for and against competition law and experience with it in various countries as well as examining the current Draft Law in Turkey.

Antidumping and antisubsidy legislation and practice of other countries, particularly the EC, and its use against Turkish exports is studied by Patrick Messerlin, who compares this with what Turkey has and does on this account.

Having covered the basic instruments of competition policy, we move up to a more global perspective. Helmut Forstner compares what theory says, with the trends and tendencies in global trade, and what seems to determine competitiveness.

Patrick Low asks where Turkey stands and should stand in the international setting, both in terms of its obligations to the GATT, EC etc., and more generally in the multilateral and regional context. Raed Safadi examines Turkey's trade potential in the region, particularly with the former Soviet Union Republics.

All the papers come up with specific proposals in their domain to improve domestic competition and international competitiveness of Turkey. In the final part, I propose an agenda for action.

II. TRADE LIBERALIZATION, COMPETITIVENESS AND INDUSTRIAL POLICY: CONCEPTUAL ISSUES

Dani Rodrik
Columbia University and NBER

During the 1960s and 1970s, the protection of domestic industries to encourage import substitution was the motivating principle of Turkish economic policy. In the 1980s, the emphasis shifted to export promotion, and the import regime was liberalized significantly. With the demise of import-substitution policies, Turkish economic policy has become open to the charge of having given up on an industrialization strategy. Nothing has yet replaced the import-substitution consensus of the previous decades, and there is widespread concern that a steadfast emphasis on exports is no substitute for a well-articulated strategy for best positioning Turkish industries in the global market of the 21st century.

This paper discusses conceptual issues related to the question of what such a strategy should look like. It is aimed at using economic theory, as well as evidence from other countries, to inform the policy debate and to illuminate frequent misperceptions on the role of government policy. The discussion proceeds from first principles, analyzing the economic case for a pro-industry policy and the shape that such a policy should take. I argue that the focus should be on explicit consideration of specific market failures and externalities which, in the absence of corrective policies, would leave industry in command of a socially suboptimal share of the economy's resources. The paper considers such market failures and the role that policy can play in addressing them. Special attention is paid to: (i) the appropriate level of protection; (ii) price versus non-price measures; (iii) the role of targeting, selectivity, and uniformity; (iv) the stability and predictability of incentives over time; and (v) the qualitative aspects of trade regimes. The

experience of East Asian countries, as well as the recent theoretical literature on imperfect competition, learning, and growth are discussed with a view to eliciting lessons.

I argue that outward orientation is not incompatible with a strategy of industrialization. But, an appropriate industrial policy is not necessarily one that selectively attempts to pick "winners" and protects them. First and foremost, it is one that establishes a stable and predictable policy environment which ensures that entrepreneurial activity receives its full reward. It is one that focuses on building the physical and human infrastructure which is the basis of industry. It is also one that presents greater rewards to those who bring new products to market and crack new markets abroad than to those who spend time trying to alter this or that government regulation to their benefit. In the absence of these conditions, selective intervention and protection policies are likely to remain ineffective at best; in their presence, such policies can do limited damage at worst.

Under pressure from various constituencies, policy makers are always tempted to try to subsidize and protect <u>all</u> activities--the textile weaver as well as the clothing producer, the import-competing producer of steel as well as the exporter. To some extent, current Turkish industrial policy is built on the fallacy that this is indeed possible. But the first thing that economics teaches is that any policy that alters relative prices in favor of one sector must have adverse effects on some other sector that now faces an adverse terms-of-trade shift. In the case of vertically-integrated industries, this is immediate and transparent: protecting the textiles producer, say, hurts the clothing exporter who now faces higher input costs. In other cases, the effects are more round-about and work through general-equilibrium interactions. But the essential point remains: every act of encouragement specific to one sector or industry has to have adverse effects on some other sectors or industries. Any industrial policy worth its name has to confront

this basic law of economics and make explicit choices regarding which sectors are more deserving than the other.

In the absence of such coices, trade and industrial policies degenerate over time into a morass of regulations that are self-defeating and of uncertain consequences. Each supplicant, often complaining of the adverse effects deriving from someone else's favorite intervention, is granted his own protective policy. In time, these interventions multiply and generate effects on resource pulls that are completely divorced from any meaningful rationale the intervention may have had originally. With the snowballing of regulations, the only distinct effects of the policy are the creation of bureaucracy, red-tape, and rent-seeking. Hence, the practice of discretionary and selective industrial policy requires a set of clearly articulated, publicly announced, and strictly implemented strategic choices.

Such choices cannot be made on the basis of a judgement as to which industries look like being winners. The tempting strategy is to project where Turkey's future comparative advantage lies, and to put public resources into such industries. The trouble with this strategy is that it gives too little credit to the private sector, which should be ready to take advantage of this potential even in the absence of government support. If government officials believe they know something about the future that the private sector does not, then the appropriate policy is to simply disseminate this information. The real rationale for public intervention, instead, is the removal of specific market distortions and imperfections. There is no reason to believe that such distortions are predominantly located in the growth industries of the future.

In addition, it is a mistake to think that the most effective form of industrial policy is that which takes place through direct, targeted intervention in specific sectors. Possibly the two most powerful forms of industrial policy are: (i) the building of physical infrastructure (transportation

networks, telecommunications, and power plants) and of human skills (technical and secondary education), and (ii) stable macroeconomic policies which produce small fiscal deficits and single-digit inflation rates. These policies do not discriminate among industries, and their payoff in terms of the quantity and quality of private investment are vastly superior to that of sector-specific policies.

Finally, the industrial strategy inherent in outward orientation should not be mistaken for one that calls for rolling back and weakening the state. The principles discussed in this paper do not aim at reducing the role of the government; rather, they aim at improving its capacity to achieve its objectives by providing clarity and greater focus to these objectives, by encouraging more selectivity in action, and by directing intervention to areas where they are the most potent.

III. THE IMPACT OF TRADE LIBERALIZATION IN TURKEY: AN EMPIRICAL ASSESSMENT

Nazim Engin and Erol Katircioglu
Marmara University

The purpose of this study is to evaluate the impact of foreign trade liberalization and of import penetration on the extent of competition in Turkish manufacturing industry, as measured by the profitability of firms. To this end, Table 1 gives summary statistics on foreign trade and market structure for the years 1982 and 1989. During this period, the nominal protection rate has decreased, on average, from 65 to 41 percent and import penetration increased from 12 to 16 percent coupled with an increase in export performance from 15 to 20 percent. The intra-industry trade index also moved in the same direction from 34 to 46 percent, indicating an increase in the variety of commodities traded, and the degree of non-substitutability of domestic products for foreign products. While all these developments were in the expected direction, the average price cost margin in industry also increased, from 25 to 30 percent, as well as the 4-firm concentration ratio, from 50 to 53 percent. According to the imports-as-market-discipline hypothesis, however, we expect an inverse relationship between import penetration and price-cost margins. The study examines this relationship at a detailed level using regression analysis.

Table 1 : Protection, Exposure to Trade, Concentration and Profitability in Turkish Manufacturing

	Year	Mean Value
Nominal Rate of Protection	1982	65.2 %
	1989	41.2 %
Import penetration	1982	11.7 %
	1989	15.7 %
Export performance	1982	14.8 %
	1989	20.0 %
Intra-industry Trade index	1982	34.2 %
	1989	46.4 %
Price-cost margin	1982	25.0 %
	1989	29.8 %
4-firm concentration ratio	1982	50.3 %
	1989	53.2 %

Source : Nominal rate of protection from Olgun and Togan, 1991. The other ratios, authors', calculations.

The Data

Industry data were derived from the Annual Manufacturing Industry Statistics for the years 1982, 1985 and 1989. Import and export data at the 4-digit SIC level were obtained from the State Institute of Statistics (SIS). The concentration ratios at the 4-digit industry level were calculated from data on the four

largest plants' shares provided by the SIS. The number of industries had to be reduced from 86 to 59 because of the concordance problems among these three data sources. In order to examine the effects of public enterprises on profits, a dummy variable was introduced. This variable was assigned the value of 1 when the share of public enterprises in the total value added of the sector exceeded 35 percent, and 0 otherwise.

Results

The most striking result of the regression analysis was that the import penetration variable, which was associated with concentration interactively, had a very strong and statistically significant effect on profitability in the Turkish manufacturing industries, as shown in table two. The direction of the effect in 1985 and 1989 was negative, which gives support to the imports-as-market-discipline hypothesis. However, a positive relationship was found in 1982.This perverse relationship is likely to take place if the implicit collusion between domestic firms is lower than that between domestic and foreign firms and if domestic concentration is low. When an oligopolist is engaged in both producing and importing simultaneously, a positive relationship may also arise. A third explanation is that quota protection is conducive to collusive behavior. Since quotas are often imposed most effectively on items for which the import share is high, this would yield a positive relation between import shares and price cost margins. The effects of quotas might have extended into 1982. Finally at the 4-digit SIC level of aggregation, the import share variable is likely to capture not only the imports of competing final products, but of inputs as well. When profitability depends on the availability of either foreign exchange or imported inputs, this is also likely to induce a positive relation between price-cost margins and import shares. We believe that the latter two explanations are valid in interpreting our findings for 1982.

The impact of exports on industry's profitability is a complex relation. In competitive markets, home sales and export sales do not differ in profitability. However, if the exporters have market power in the domestic market and can effectively discriminate prices between home and export markets, an expansion in exports can increase the overall profitability of the industry.

Our findings reveal a positive and statistically significant relationship between export performance and price-cost margins for the years 1982 and 1989, and a statistically insignificant and negative relationship for the year 1985. The positive sign can be explained by the high concentration and protection in the manufacturing industry.

Another explanation for this positive relation is the fact that during the greater part of 1980s exports were heavily subsidized, creating higher price-cost margins in export sales than domestic sales.

An index of intra-industry trade was also included into our equations. As intra-industry trade is greater in differentiated goods, profit margins can be expected to be higher. Our results show that as liberalization proceeded, intra-industrial trade increased, as well as the positive impact of that on profits.

The inefficiency of public enterprises is one of the most important causes of the budget deficit. In order to see whether being publicly owned mattered in this context, we included a dummy variable into our regression equations. In all the three years, considered, the coefficient of this dummy was negative and statistically significant. Being state owned meant being less profitable, and the inclusion of this factor slightly improved the overall explanatory power of the analysis.

Table 2: The Determinants of Profitability in Turkish Manufacturing Industry

	1982	1985	1989
I	-2.29	-1.79	-1.71
	(-3.23)	(-2.74)	(-2.66)
CR x IM	0.0423	-0.062	-0.059
	(1.81)	(-2.47)	(-1.90)
EXP	0.0761	-0.015	0.049
	(2.68)	(-0.48)	(1.24)
HET	0.0217	0.057	0.092
	(0.68)	(1.83)	(1.97)
CR	0.0194	0.374	0.386
	(0.23)	(3.69)	(3.59)
GOV	-0.25	-0.204	-0.157
	(-2.09)	(-1.94)	(-1.58)
R^2 adj.	0.26	0.27	0.14
F	3.78	4.13	2.38
No. of obs.	57	59	59

t - values are in brackets. Dependent variable is the logarithm of cost-price margin. All explanatory variables are also in the logarithmic form. The estimation method is ordinary least squares.

I = constant term
CR = concentration ratio
IM = import penetration ratio
EXP = export performance
HET = index of intra-industry trade
GOV = dummy for public enterprises

Conclusion

While the overall concentration as well as average profitability in manufacturing industry increased during the 1980s, it seems that trade liberalization and import penetration had some restraining effect on price cost margins. Most likely the predominant factor behind the increase in average profitability during the 1982-1989 period was suppressed real wages, an issue which is not analyzed in this paper.

Our findings support the imports-as-market-discipline hypothesis in a statistically significant manner. However, the results are not robust. We can allow two speculations. First, the reduction in nominal protection rates might be overestimating the actual scope of liberalization. Second, the aggregation level of our data might not have been sufficiently detailed to capture a stronger link.

IV. LIBERALIZATION AND COMPETITION IN TURKISH FINANCIAL MARKETS

Cevdet Denizer
The World Bank

Until 1980, the Turkish financial system developed under a tight regulatory environment characterized by conservative entry policies, administratively set interest rates and other constraints on financial intermediation characteristic of financial repression. However, viewed broadly and in retrospect, it can be said that such financial policy was aimed at supporting or complementing import substitution strategy Turkey followed between 1963-80 rather than at indiscriminate financial repression. In order to direct resources into capital intensive areas, this strategy intervened into the financial, or more precisely the banking system, by fixing interest rates below their equilibrium levels and by establishing directed credit programs. A direct result of this policy has been non-price competition in the form of excessive branching of banks which were in the system already. Coupled with restrictive entry policies and exit of a number of banks during the 1960-80 period, this situation has resulted in a high degree of concentration in the banking sector in terms of deposits, loans and assets. As a corollary, the banking system developed into a noncompetitive and inefficient one over the years prior to 1980, dominated by public banks and private banks owned by industrial groups.

In 1980, as part of the structural adjustment and economic stabilization policies, the government launched financial reforms aimed at developing a competitive and efficient financial system that would support and facilitate the functioning of a more liberal economy. This was to be achieved through deregulation and

promoting competition in the financial sector. To this end, reforms included the lifting of interest rate restrictions on deposits and loans, easing the entry of new financial institutions into the market, and allowing of new types of financial instruments. The initial phase of deregulation saw sharp increases in interest rates and an attempt by the larger banks to hold them low through a gentlemen's agreement. However, faced with higher rates offered by the unregulated brokerage houses the gentlemen's agreement proved unsustainable resulting in a fierce competition in the sector. This situation, in combination with financial distress in the real sector because of high interest rates has led to the collapse of six banks in 1982. These developments led to a partial reversal of reforms and the Central Bank, although at much higher levels compared to pre-1980 situation, began to reregulate interest rates, and at the same time underlined the importance of a sound supervisory and regulatory framework.

The Central Bank continued with the regulation of deposit interest rates until 1988 occasionally adjusting them to maintain positive real rates of return. In late 1988, deposit rates were again liberalized and since then this policy was maintained with several temporary interventions. Thus, the switch to price competition was not complete before late 1988, although the reform process started in 1980. Nevertheless, despite occasional setbacks, higher levels of interest rates and deregulation have resulted in substantial growth of the financial system and financial deepening relative to pre 1980 situation. By the end of 1991, the stock of financial assets reached to 54 percent of GDP from 25 percent in 1980 while M2/GNP ratio reached to 25 percent from 18 in 1980. In line with financial liberalization policies, reserve requirements were lowered and most directed credit programs and preferential rates were eliminated contributing to more efficient allocation of resources during the past decade.

Reforms were also successful in attracting entry into the system, one of the key objectives. Easing of entry restrictions have resulted in the establishment of some 30 new banks by the end of 1991, bringing the total to 66 from 43 in 1980. 9 banks were either liquidated or merged with others. As a result of this, concentration in banking industry has declined in general. However, almost none of the new banks have entered into retail banking. Although there are no restrictions on the scope of their operations they specialize in trade financing and in investment banking activities. Hence, the pre-1980 banks with vast, possibly over extended, branch networks distributed throughout the country remained dominant in the retail banking market. Nevertheless, the establishment of new banks particularly the foreign ones have improved the quality of financial services, product variety, and financial technology as well as contributing to the globalization of the Turkish banking system.

What has been the impact of financial reforms on the nature of the banking market structure and competition? Have sunk costs actually been acting as effective entry barriers? What can be said about the competeiveness of the Turkish banking system after more than a decade of reforms? This study is an attempt to answer these questions. By drawing upon market structure studies found in the literature on banking industry, a number of hypotheses have been developed and presented to the Central Bank for testing at their facilities. The first part of the study utilizes the structural approach. In general, this approach draws inferences about the market structure and competition by studying the relationship between market concentration, a proxy for market structure, and profitability, a proxy for performance within the context of two competing hypotheses.

The first hypothesis is the structure-conduct-performance (SCP) idea and maintains that market structure is a primary determinant of the conduct of market participants and hence their

performance. In other words concentration determines the profitability of banks. This implies that the market structure is not competitive. The second hypothesis is the efficient structure hypothesis, which argues that the correlation between concentration and profits is due to the efficiency of firms (banks) with high market shares. The efficiency of banks result in high market shares and hence concentration. The underlying link, it is argued, is in fact between market share, proxying efficiency, and profits. A significant and positive correlation between the two variables would imply that the market is competitive and concentration does not matter. This study tests the validity of both hypotheses for the Turkish banking market and determines if profitability is due to concentration or bank efficiency. The results indicate that market structure is the primary determinant of bank profitability in Turkey and ESH does not hold in this setting.

Who benefits from market concentration? Only the leading banks or smaller (fringe) banks or both? In order to answer this question the following method was used. The data set was divided into two, one for the leading firms, and one for remaining fringe firms. Then, the profit-concentration relationship was investigated using the two separate data sets but using the same concentration ratio. This method is also an indirect test of the validity of the SPC and efficient structure hypotheses. If the concentration is significant for both large and small firms then market concentration benefits all market participants and the SPC hypothesis holds. It may also indicate the presence of price leadership, i.e. smaller firms basing their pricing decisions on the leading firms' decisions. If on the other hand the concentration-profitability relationship is only significant for the large firms, and not significant for the fringe firms, then large firms are more efficient than smaller firms. In this case the efficient structure hypothesis holds. Results indicate that concentration is significantly related to profits of both the large and smaller banks. This finding which supports the SPC hypothesis,

is consistent with earlier findings and underlines the importance of market structure in explaining bank profitability in Turkey.

The second part of the study analyzes the effects of entry and leading firm size on competition. Theory suggest that, apart from regulatory effective restrictions, leading firm size might act as an effective entry barrier. In other words, the size of entry might be more important than entry itself. A corollary to this is that entry will be more powerful in reducing concentration if the newcomer's size is equal or close to the average size of existing firms. As mentioned earlier, despite new bank entry, the Turkish banking market is still dominated by large banks with vast branch networks which might dictate a minimum size for new entrants to be effective competitors. If so, entry by itself might not increase competition. What has been the effect of large branch network on competition, and did the entry of new banks change the situation? In order to answer these questions two hypotheses were put forward and tested.

The first hypothesis analyzes the relationship between competition, the dependent variable, and independent variables, new entry, concentration and leading firm size. Competition is proxied by mobility and turnover. Theory suggest that, ceteris paribus, new entry of firms will increase rivalry in a market and this should be reflected in the rank changes or mobility of leading firms. In other words mobility indicates churning about in the rank position of leading firms and should thus reflect the degree to which dominant firms compete regardless of the methods employed. Turnover, on the other hand, accounts for changes in the identity of the leading firms arising from entry by lower echelon firms, reflecting aggressive, competitive behavior. The relative importance of each independent variable on competition is assessed by regressing mobility and turnover measures on proxies of new entry, size and market concentration. Results indicate that the

impact of new entry on rivalry has been minimal. However, the effects of size have been substantial. This suggests that size of the incumbents has been an effective barrier for rivalry, and effective competition in the banking sector requires a certain size. New banks fill certain niches in the market with new specialized services but their impact on competition at retail banking without a sizeable branch network has been limited.

Finally this study utilizes a non-structural estimation technique to draw inferences about the market structure and competitiveness of banking industry in Turkey. By utilizing this method it is also possible to see if the two different approaches, structural and non-structural, produce different results and hence different implications on the nature of market structure. The non-structural method estimates the sum of elasticies of total revenue with respect to input prices. It is shown in this literature that this sum cannot be positive if an industry is a monopoly. Under perfect competition this sum is positive but not greater than unity For a natural monopoly it is unity. By utilizing the same data set, the elasticity of total revenue with respect to input prices, labor and capital has been estimated for the Turkish banking industry. Results indicate that market structure is not perfectly competitive, consistent with findings based on structural approach.

Results obtained in this study have implications for financial sector policies in general and banking industry in particular. They demonstrate that bank profitability is primarily due to market concentration and not to firm specific efficiencies, and that increases in the number of fringe firms through new entry had a procompetitive effect but this was not as strong as expected. These findings suggest that the retail banking market did not evolve into competitive one during the last decade. Our claim seems to be validated with the actions of the authorities as well. In a number of occasions in the past and recently, the public banks have been directed to raise their deposit rates when large private

sector banks set their rates below the smaller banks and below the inflation rate. While this policy achieved its immediate objectives, it has some drawbacks. First of all it is likely to be a short term measure and depends upon the will of authorities and cannot be regarded as a long term policy tool to promote competition. Second, rate setting by the authorities would be against financial liberalization. In fact it would be what is called "upward financial repression".

Given our findings, a procompetitive policy would need to facilate inter-bank rivalry among the top 10 banks. This in turn requires the entry or creation of new banks with a reasonable number of branches. In other words, what is needed is entry at a certain size. In the short term this could be achieved by breaking up and privatizing public banks, except probably in some special cases, such as the one serving the agriculture. Breaking up of the public banks is not likely to lead to welfare losses because of loss of scale economies as private banks with 30-50 branches seem equally or even more profitable than public banks with larger number of branches. Hence, breaking up public banks, currently representing 30 percent of sectoral assets (excluding the agriculture bank and 3 development banks) can easily result in creation of some 15-20 new banks with 40-50 branches. Such an outcome, if materializes is likely to reduce concentration and lead to a competitive retail banking market.

Promoting the entry of non-banks and local banks would also be desirable. Despite easing of entry restrictions, non-banks dealing in retail banking have not entered into the system. In the West, savings and loan associations or building societies actively compete with commercial banks forcing them to be efficient and competitive. Therefore, although the banking market is concentrated in Germany and the U.K., the existence of non-banks reduce the effectiveness of concentration. In Turkey, such an alternative is not available to depositors. The establishment of non-banks for

housing finance seems to be a good idea both for competition in the financial market and for the creation of a mortgage market. Promotion of local banks should also be given serious consideration. During the 1923-32 period, most banks were local, often with a single branch. Surviving banks then evolved into multibranch national banks between 1945-1970, and at the present there are only 1 or 2 local banks. Entry at the local level is likely to increase inter-bank rivalry and hence competition. Lowering of capital requirements to stimulate entry might be a good approach, at least for a while. This will however, require, the expansion of the supervisory and regulatory capacity of authorities, particularly the Central Bank.

V. THE ROLE OF SUBSIDIES

Refik Erzan
Bogazici University / The World Bank

Subsidies constitute an important component of the terms of competition. Since the mid-1980s subsidies came increasingly under focus in international trade: in the context of "strategic trade policy" among academics, and as an instrument of "unfair trade practices" in foreign trade policy debates. Nevertheless, making a strong case for subsidies in the name of "national interest" remains a challenge. Similarly, the foreign supplier who subsidizes your consumption often should not warrant much worry.

The GNP share of State aid in Turkey is a fraction of that in the EC. This advantage of Turkey is interpreted differently by various circles in the current policy debate. It is considered, by some industrial policy advocates, a potential for increasing the subsidy level in Turkey without facing major international retaliation.

Investment Incentives

During the 1960s and 1970s, as Turkey carried out an import substitution strategy, the main instrument of industrial policy was protection. Quotas and licenses applied to both final products and inputs yielded huge rents to the investors. While the nature of these instruments gave complete control to the government in directing investment, the strategy did not follow a predetermined pattern, especially until the early 1970s. After all, not much money was coming out of the budget. In 1968, the State Planning Organization (SPO) started issuing "certificates of encouragement" for investments. Eligible investments were receiving subsidized credits, as well as enjoying certain exemptions from customs duties and tax breaks. However, with a regulated domestic credit market and severe international

exchange and payments' restrictions, the real interest rates could be kept low. Hence funds spent on subsidized credits were manageable.

In the 1970s, the government started encouraging import substitution to move on to investment goods and intermediate inputs. Again the foreign trade regime was the main instrument. However, the emphasis on "heavy industry" investments was actually achieved directly through State economic enterprises(SEEs).

From 1968, when it was first introduced, until the end of 1980, about 4,800 investment encouragement certificates were issued. The corresponding number for the 1981-1991 period is nearly 27,000. Some proponents of a selective industrial policy criticize this development and advocate a return to the 1970s in this respect.

To qualify for various investment incentives (with minor exceptions) investments must receive encouragement certificates. Limitations on the eligibility of investments for the encouragement certificate are few.

The matrices determining the eligibility of an investment for various incentives and their rates are three dimensional: location, sector/activity and scale. In addition to minimum scale requirements in each sector, the size of the investment matters. Besides new investment, expansion of existing capacity, completion, renewals, restorations, modernization, integration or transportation of facilities, investments for quality improvement are eligible for incentives under the same framework. Applications can also cover leasing, and projects to "eliminate bottlenecks".

Trends in Investment Incentives

With the explosion in the number of investment encouragement

certificates granted in the 1980s, monitoring the realization of the investments became nearly impossible. The SPO has delegated some of its functions and monitoring duties to the district governors (handing out VAT refunds) and public banks (extending subsidized credits). While probably an innovative approach in decentralization and cutting the red tape, the statistical information on investments receiving State aid deteriorated sharply.

Were the incentive schemes of the 1980s effective in giving direction to investments?

On the location, sector/activity and scale matrix, the incentive schemes contained a consistent and pronounced direction concerning only one, the location. Both tax and financial incentives were geared to move industry from developed regions into less developed areas or to organized industrial zones. Concerning sectors, it was difficult to make a generalization that could cover the whole of 1980s. There was also a large number of very specific activities that were promoted. One generalization that can be made is that most of these very specific items related to tourism, exports or other foreign exchange earning activities. Finally, with respect to production scale, other than minimum requirements, there was no strong preference.

I made an effort to determine whether there was any relation between encouragement certificates and performance. Based on very weak statistical results, it might be stated that the government largely followed investment demand in issuing encouragement certificates. Another weak finding is that sub-sectors with low export performance probably got some priority.

For an overall evaluation of the investment promotion policy during the 1980s, it can be said that, by design <u>and</u> by default, there was little direction. However, the promotion of specific activities, most related to tourism, exports and other

foreign exchange earning areas may have achieved results. An indication of this was the tripling of the hotel/motel beds during the decade. The corresponding increase in the number of tourist arrivals was from 1,5 to 5,5 million, and revenues from $ 0,5 to $ 3,5 billion.

Export Incentives

Until 1980, when the exchange rate was fixed, the Turkish Lira was overvalued with the exception of brief periods following devaluations. This, combined with an extremely high protection on imports, yielded an "effective exchange rate for exports" considerably lower than the "effective exchange rate for imports". To compensate for this discrimination, starting from the early 1960s, the government was providing substantial financial incentives to exports. With the shift to export orientation in 1980, a market based exchange rate policy was adopted. However the financial incentives to exports were not removed. On the contrary, the subsidy rates were increased. Presumably, the purpose was to make exporting excessively profitable to break the inertia of import substitution. The policy succeeded in a way, however it started an avalanche of rent-seeking activity and corruption. In 1986 Turkey signed the GATT subsidies code and pledged to phase out the outright export subsidies by 1989. Also, in the 1980s, the foreign exchange retention schemes lost their value as the black market for foreign currencies disappeared.

The 1992 export incentive scheme introduces the energy subsidy and increases the premium on transport costs to distant destinations. In addition, most tradable services are made eligible for export promotion measures. Eximbank credits are expanded and the former Soviet Republics get generous quotas in these subsidized credits. In terms of the specificity of export subsidies, there is targeting by market, rather than by product. All exports which are not contained in a short list of exceptions are eligible for incentives. The Turkic Republics of the former

Soviet Union is the prime target.

The Current Strategy Debate

The current calls for an active industrial policy partly stem from the concern over the low level of investment. As improving the macro-economic environment would take time with the best of efforts, the government is paying tribute to an industrial policy which would make investments more attractive. Also, reacting to the slowdown in export growth, the "conventional wisdom" is supporting the exports at the level of investment and production activities. However, with a public sector borrowing requirement exceeding 12 percent of the GDP, and a third of all government revenues spent on servicing the external and internal debt, funds are extremely limited. Given these circumstances a selective industrial policy and the use of new protectionist instruments (notably anti-dumping investigations and other import surcharges), both finding strong support among certain business circles, are becoming tempting for the government.

The Turkish Businessmen's and Industrialist's Association (TUSIAD) advocates developing an industrial policy through dialogue between the government and the private sector. This Association, which draws its membership from the large private enterprises, emphasizes sectoral policies and the need to build up comparative advantage. The Turkish Union of Chambers and Exchanges (TOBB) apparently takes a more liberal stand. Covering a broader range of industrialists and merchants, TOBB puts the emphasis on macro-economic stabilization. Industry subsidies are to be phased out, while subsides to improve education and health services are advocated.

Large enterprises are much less affected from adverse macro-economic conditions. Their market power often allows them to pass on cost increases to their clients. Loans from the conglomerates' own banks bear interest slightly above deposit rates and they

make maximum use of subsidized credits, both for investment and exports. However, large business in Turkey is a big stakeholder in the future of the economy. With increasing awareness, TUSIAD has been internalizing the problems of the Turkish economy. Therefore its position cannot be interpreted merely as a defense of big business interests.

Proponents of an active industrial policy for Turkey base their case on three arguments. First, is the stagnation in investment, particularly in the manufacturing industry, and the associated slowdown in export growth. Second, is increasing labor costs and expectations that this trend will continue at a pace which will deprive Turkey of its comparative advantage in labor intensive products. The proposed solution is accelerating technology transfer and "building up" comparative advantage in some of the high-tech industries. This view is supported with the perceived success of industrial policy in generating rapid growth and export expansion in the East Asian NICs. The third main argument is the desire not to let skip by the economic opportunities in the region following the collapse of the Soviet Union.

I dismiss the first argument since stagnation in investment is in the domain of macro-economic policy. It is true that capital formation slows down in most countries which liberalize their trade and especially financial system.Some economists argue that financial liberalization should not come early. In any event, this is an irreversible fact for Turkey. When the government "crowds-out" private investment to finance its deficit, there is not much that industrial policy can do. There is substance as to the second and third arguments. These are analyzed in several papers presented in this volume.

1992 Incentive Program

While the current government is critical of the lack of direction in the previous incentive schemes, the 1992 program

does not constitute a major departure. Selectivity is somewhat increased in terms of economic activity by excluding a list of sub-sectors altogether from the investment incentive scheme. Investments in the educational and health fields, environment and technology are put in the highest premium class as well as "large scale" investments and completion of unfinished projects. However, the program is as cumbersome as the previous ones, including promotion of some very specific activities. These are special provisions for construction activities and investment in the former Soviet Republics and expanded Eximbank credits to this region. The funding of these measures are on questionable grounds.

What Next ?

As discussed in the conceptual framework of this volume by Rodrik, in the absence of an institutional setting characterized by a "hard" state and strong government discipline over the private sector, industrial targeting would not work.

In any event this is a hypothetical consideration in the current Turkish case since the premises of undertaking a coherent strategy are absent. Any incentive scheme has two sets of instruments: tax incentives and cash incentives. Due to the current tax breaks, enterprises pay an average of 10 to 15 percent corporate tax while the nominal rate is 46 percent. Banks, which finance the budget deficit by buying tax deductible government bonds, manage to cut down their corporate tax rate to about 7 percent. The customs duties are no exception. Although the average rate for duties and surcharges is about 40 percent, due to the exemptions, the actual rate based on duty collection is about 10 percent.

As to cash incentives, available funds will be extremely limited given the fiscal situation.

To make tax incentives potent instruments, the taxation

system has to be radically reformed by cutting down the base rates and abolishing most of the tax benefits. An integral part of the latter is scrapping and rewriting a much simpler and transparent investment and export encouragement scheme.

Concerning import duties and surcharges, the fact that the duty collection based rate is one fourth of the nominal rate implies that there is a major distortion in the system. When there are so many exemptions, those few who pay full duties carry the whole burden. The import surcharges have to be phased out according to a fixed schedule. I have a specific proposal to this end, spelled out in the final part of this volume. Parallel to this, most of the existing duty exemptions have to be eliminated.

Special Areas

There are three areas in addition to physical infrastructure, health and human skills, where the government should focus. The first is the promotion of small and medium size enterprises and new entrants. The second is priority development regions. The third is a regional strategy - discussed elsewhere in this volume. In all these areas, while some specific measures may be permissible, institutional reforms and arrangements, and general measures which work through the markets should be the main instruments.

Promotion of Small and Medium Size Enterprises and New Entrants

Small and medium size enterprises (SMSEs) in Turkish manufacturing industry accounted for 53 percent of the employment in this sector and produced 25 percent of the value added. (The figures are quite comparable with the EC.) Against that, a recent survey revealed that only 19 percent of these enterprises used bank credit and 7 percent of the firms made use of any incentive schemes (and these were almost exclusively export incentives). The public sector bank, Halkbank, which is the main source of

credit for SMSEs has a share of 7 percent in total commercial credits in Turkey.

New investment, modernization and expansion of SMSE often fall below the treshhold to qualify for investment encouragement - except in priority development regions. Similarly, the minimum annual shipments to receive export incentives and Eximbank credits surpass most SMSEs' export capacity or past record on which such support is based.

This discrimination against SMSEs is by design. Relatively high administrative costs in dealing with a large number of firms as opposed to few large ones is a legitimate concern. Low productivity and backward technology arguments from the "big is good" era constitute the ideological cover for this discrimination. Nowadays, it is a widely accepted fact that most technological innovations in industrial countries originate from SMSEs. Furthermore, in many activities, technology (particularly electronics and informatics) has considerably reduced minimum scale requirements. Finally, new entrants are the main stimuli for competition, and entry at a small scale can be feasible in many activities and sectors.

Given the prominent role of SMSEs in employment creation in a country with a record unemployment rate, the main reason behind the discrimination against them in Turkey, as in any other country, is their relative weakness in lobbying. This manifests itself not only in defending their special interests but as well in shaping the priorities in general policies. As voiced in the current debate in Turkey, SMSEs lean towards an industrial strategy geared to improving the functioning of the markets. Macro-economic stability, low inflation and low interest rates are crucial for their prosperity. Furthermore, SMSEs would benefit from general State aid to education, health and the infrastructure more than propationately compared to large firms as their capacity to carry overheads is considerably smaller.

Specific Measures

Some specific measures can also be warranted to promote SMSEs.These would be geared to improve their access to the factor (capital, skilled labor and technology) and product markets, both domestic and international.

The SMSEs in Turkey are not altogether deprived from support. The local chambers of commerce and industry and various public bodies and semi-official associations, founded by the SMSEs with public support, provide advice in finance, marketing, education and technical know-how, as well as providing collateral and financial support. However, the survey mentioned above has found that about 90 percent of SMSEs were unaware of the existence of such centers and activities. The newly founded Administration for Development and Support of Small and Medium Size Industry (KOSGEB) aims at coordinating efforts of the government in this area and the functions of various SMSE associations as well as universities and research centers. As its first priority, rather than assuming new functions, KOSGEB should reach out to the SMSEs to inform them of the existing bodies and activities at the service of the SMSEs.

Access to capital markets: Unlike large business, SMSEs do not have corporate links with the banks. SMSEs have major problems in providing collateral to the banks for commercial credit. In any case, the commercial banks do not extend medium and long term credits, and short term credits available to SMSEs cost up to 60 percent in real terms. The main source of subsidized credits for SMSEs, Halkbank, is far insufficient in funding and management to put SMESs at par with large enterprises.

To be eligible for the Eximbank's subsidized export credits, a track record of $ 1 million in shipments during the previous year is required. Few SMSEs fulfill this eligibility requirement. The avenue currently open to them to benefit from such credits

is to make their sales through a "foreign trade joint stock" company which fulfills the requirement. This was designed to encourage small producers to join forces, and to cut administrative costs of the Eximbank in screening loan applications. The Eximbank can abolish the track record requirement subject to certain conditions. To reduce screening costs, it can rely on commercial banks which are willing to co-finance a certain minimum percentage of a transaction. Alternatively, Eximbank can rely on certified public accounting firms in small loan applications, and charge higher export credit guarantee premiums.

Helping the SMSEs with their collateral problem would improve their access to bank credits and lower interest charges. The government should institute a loan guarantee scheme for SMSEs' short term credit needs along the lines of such schemes in the US, the UK and continental Europe. The management of the scheme and credits extended under this umbrella should not be under the monopoly of any State bank. All commercial banks, public and private should be to participate in the program. In extending the guarantees, the government should rely on certified public accounting firms, and these firms should be required to hold consultations with the public and semi-public bodies in the SMSE area to tap their local knowledge about the particular industry and the loan applicant.

For the medium and long term capital needs of SMSEs, the government should institute an investment loan guarantee scheme. Institutional investors should be given tax incentives to extend such credits under this scheme. Investment funds, life insurance companies and pension funds, including the public social security system, are the prime resources to be tapped.

Both loan guarantee schemes have to be financed from the treasury. However to avoid a skewed and risky portfolio, the schemes should be made attractive to robust SMSEs as well.

A very promising finding of the survey on the SMSEs was that 89 percent of these firms were considering to float their stock in the stock exchange. The fact that very few of them are actually listed points to the lack of know-how and high costs involved. The unlisted securities market in the UK is a good solution where quotation costs are minimal and minimum share flotation requirements are lower than the stock exchange.

Finally, to provide risk capital for new entrants as well as expansion of existing small businesses, a venture capital scheme is essential. Currently, there are preparations to start such an operation under the auspicies of the public Development Bank. Given public funding difficulties, it is unlikely that the plan will have any substantial impact. Furthermore, asking bureaucrats to evaluate risky projects to invest government money is in contradiction with the whole concept. It should be considered to establish private venture capital companies by tax exemption. This scheme should be promoted internationally to attract foreign investors.

To provide SMSEs with know-how, the universities and technical schools can be tapped. As research is anyway suffering from lack of resources, the government should provide working capital for these schools to set up consultancy agencies and make the necessary legal arrangements. While those "agencies" would be run on private enterprise principles, their revenue from serving the SMSEs can be tax exempt.

SMSEs are not all angels of competition, however. Many are worse polluters than large scale firms (in proportion to their output), tax evasion is widespread, labor without social security cover is employed, safely and security standards are usually ignored. The specific measures should be designed with the double purpose of giving the SMSEs a boost while bringing them under the umbrella of the general standards. As many SMSEs would partly lose their cost advantage in this process, during a transitionary period, cash incentives and tax benefits might

be provided. Such incentives can be tied to voluntary inspection schemes. Improved accounting practices can be rewarded by tax credits while investment upgrading working conditions and environmental standards can be supported by subsidies.

Priority Development Regions

GNP per capita in first degree priority regions is one third of the Turkish average and unemployment is twice the national rate. The social, political and security consequences of this skewed distribution is one of the highest priorities in Turkey. All five year development plans, yearly programs and incentive schemes had generous provisions to promote all economic activity in those regions with very little result. Despite the increase in the number of investment encouragement certificates granted to these regions in the recent years, the realization rate of investments is extremely low. The explanation lies in the fact that, how generous the tax and cash incentives may be, they do not compensate for the adverse economic conditions. The local markets are too thin, skilled labor is scarce and the infrastructure is not developed. Social unrest is an additional factor, scaring away investment, thus completing the vicious circle.

Turkey seems to have followed the example of the EC in its approach to regional development. The closest parallel is with Southern Italy, which has been receiving enormous sums in subsidies and tax benefits since the 1950s. Currently Italy receives about 40 percent of all grants from the EC regional fund and has similar shares in the other funds to promote agriculture, industry and living standards. While Italy's overall GDP per capita is roughly at par with the EC average, Southern Italy's is 30 to 40 percent below this average. Unemployment is also nearly twice the Italian rate. The instruments used in promoting economic activity in Southern Italy are very similar to the Turkish ones. The results after forty years, however, are very discouraging.

The alternative to investment promotion seems to be a project based approach with a central authority for the region. There are two versions of this model. The prototype of a central authority with wide ranging powers is the Danodar Valley Corporation in India. The other version is the "river basin" projects in the US, with the classic example of the Tennessee Valley Authority (TVA) of the 1930s. In promoting industrialization, besides providing flood control, irrigation and hydro-electric power, TVA only assumed research and planning roles in support of private enterprise.

During the 1930s the rate of growth in investment and employment was 10 to 15 percent higher than the US average in the TVA area. Also the increase in per capita income was nearly 50 percent higher in Alabama Mississippi and Tennessee. Even after giving allowance for the depression in the industrial centers of the US, the results achieved by the TVA were very encouraging.

More "GAPs"

The bright spot in regional development efforts of Turkey is the South East Anatolian Project (GAP). When completed in year 2005, with 22 dams and 19 hydroelectric power plants, GAP will account for a third of Turkey's land under irrigation (from 4 percent before the project) and one forth of the hydroelectric power. In philosophy, GAP Regional Development Administration is close to the TVA. However, in addition to research and planning, it has the coordination function for all public development efforts in the region.

Replicating the GAP experiment - which revolves around the huge water and energy potentials of the Tygris and Euphrates rivers - in other regions on smaller scales is a tempting idea. In any case, from the institutional point of view, the performance of the GAP administration in fulfilling its coordination functions and in balancing public and private initiatives will have to be closely watched.

The principles and instruments to deal with companies in distress are discussed in the paper on restructuring and exit policies. Concerning priority development regions, we have a specific proposal which entails subsidies if certain conditions are met.

VI. RESTRUCTURING AND EXIT POLICIES IN TURKEY

Izak Atiyas
The World Bank

Restructuring and rehabilitation of distressed firms has been on Turkeys's agenda throughout the last decade. First, the implementation of a stabilization program in the early 1980s radically changed the economic environment surrounding the corporate sector. Especially those companies that were nurtured through subsidized credit policies, or sheltered from foreign exchange risk through government guarantees found themselves faced with both significant increases in domestic interest rates, and steep devaluations. Already characterized by over-leveraged capital structures, they experienced an erosion of their financial viability. Second, some firms encountered difficulties restructuring their production in line with the requirements of a more outward oriented economy that emphasized import competition and export promotion. The viability of another class of firms, in particular those established in priority regions, was put at risk from the beginning through a haphazard system of subsidies and incentives that was rich in fiscal and financial support, but poor in performance criteria, screening, and monitoring. The changing economic environment, and reduction or elimination of subsidies simply brought to light their inherent weaknesses.

The purpose of this paper is to evaluate the economic environment surrounding corporate restructuring efforts in Turkey, and in particular, to review government policies during the last decade towards distressed companies and provide recommendations on how they can be improved.

The Problem of Restructuring

When a company loses competitiveness, experiences financial

distress and is in need of restructuring, there are basically three options. The company may be closed down, reorganized and rehabilitated, or no drastic action may be taken. Efficient restructuring requires that each of these options are implemented whenever it is socially optimal to do so. In particular, exit, partial exit or divestiture may be desirable outcomes of restructuring. The reorganization and rehabilitation option, on the other hand, involves the restructuring of both the assets and liabilities of the firm.

Corporate restructuring decisions face important barriers. Lack of discipline protects enterprises from competitive pressures and encourages firms to delay restructuring. Barriers to mobility of capital and labor increases the costs of the necessary redeployment of resources. Resource related barriers (especially lack of skills, information and finance) prohibit firms from undertaking efficient restructuring even when they experience competitive pressures, and are not constrained in otherwise redeploying productive factors.

Overcoming those barriers requires a comprehensive and mutually consistent set of government policies that create an environment which is conducive to efficient restructuring. Among those barriers, this paper will pay particular attention to those that constrain the availability of finance, since that seems to represent the main focus of the government's approach to restructuring in the last decade. Elements of a more comprehensive approach to restructuring will be discussed in section 4.

Financing the restructuring activities of a distressed firm is a particularly risky business. This is because financial distress aggravates adverse incentive effects, or agency problems, associated with external, especially debt financing. Among the various agency problems that have been identified in the literature, the most relevant in Turkey are those associated with

the diverging interests of creditors on the one hand, and owners and managers on the other. The problem is that because of limited liability, once debt financing is secured, owners have incentives to attempt to transfer wealth from creditors by increasing the riskiness of the firms' activities.

This problem is aggravated when the debtor firm experiences financial distress and its survival is endangered. Managers or owners may attempt to prolong the survival of the firm by taking undue risks. If the survival of the firm is almost an impossible event, then, owners and managers strip the assets of the firm so that if the firm goes bankrupt, the value of the remaining assets acquired by creditors is very low. Hence, in order to provide finance, creditors need to make sure that the resources are going to be used efficiently, rather than to further the benefits of the owners or managers.

Given these agency problems, in order to finance restructuring, creditors need to be able to monitor the activities of the firm. Perhaps more important, they often need to acquire control rights over the firm so that they can dictate the restructuring measures that may in many cases run counter to the interests of the managers and owners. In many cases, this implies that creditors have a say in the management of the firm, at least until profitability is restored and the adverse incentive effects of financial distress are eliminated.

Restoration of profitability is predicated on the adoption of a set of restructuring measures. These measures address both real and financial problems that impair profitability. On the real side, they include changes in the product mix of the firm, adjustments in capacity, adoption of more appropriate technology, a redefinition of marketing focus (and often export orientation), and so on. On the financial side, they often include agreements between the creditors and the firm to redistribute the financial claims on the

enterprise. Such agreements may include debt writeoffs or rescheduling, as well as conversion of debt into equity. Besides reducing the debt burden over the firms, debt-equity conversions also grant creditors some control rights and hence may make them more willing to provide additional finance.

An important determinant of the efficiency of the outcome of restructuring policies is the way they, and the institutional environment in the economy, affect these agency problems. There is substantial variation among countries' policies in the area of corporate restructuring; countries also differ in the way they attempt to resolve the agency problems mentioned above. In stock market based economies, such as the US and the UK, bankruptcy reorganization procedures provide one of the main mechanisms. These economies also rely on informal reorganizations for corporate restructuring. Informal reorganizations also stipulate agreements between creditors and debtors. However these agreements are reached without a formal bankruptcy procedure. In Japan, where the banking system, rather than the stock market plays a major role in corporate finance, corporate restructuring often takes place under the leadership of a "main bank". Bankruptcies, especially in the case of large firms, are rare. When a firm experiences financial difficulties, its main bank intervenes and appoints its representatives to join the management. In Korea in the 1980s, the government directly intervened in the restructuring of individual subsectors and even companies. The government also literally forced the banking system to finance these activities.

The Turkish Experience in the 1980's

The overriding concern of the Turkish approach to restructuring has been the prevention of job losses. The main element of actual or proposed government policies has been the provision of finance to maintain the survival of, or to rehabilitate distressed companies. Policies in this area can be

summarized under three headings: the Company Rescue Law, random bailouts, and policies towards distressed firms in Priority Development Regions (PDRs).

The Company Rescue Law. The first somewhat systematic effort to develop a government policy towards distressed companies in Turkey was the enaction Law No. 3322 in 1987. The Law attempted to provide a legal framework to rescue companies in financial distress by promoting negotiations and an agreement between the company and creditor banks, whereby banks would convert their debt claims into equity, and gain control over assets. The positive aspect of this was that, at least in principle, a company was to be rescued only if the creditors was willing to do so. However, the law lacked several procedural and substantial details that are necessary to protect the interests of different parties. It granted the largest creditor a dominant position in negotiations, leaving banks with smaller claims both out of the decision making process, and with no options other than accepting the agreement or suffering substantial losses in the value of their claims. It did not provide a priority ordering among different classes of creditors; in particular, it did not recognize the seniority of secured debt. The implications of conversion of debt claims into equity for assets provided as collateral against debt claims was also not clear. Moreover, it lacked an adequate check against fraudulent conveyances; in other words, it had no mechanisms to allow creditors to legally assess the validity of recent transactions that may have changed the asset and liability structure of the firm.

The law did not become a popular means of company rehabilitation. In fact, only one prominent rescue operation took place in the context of the law, that of Man-Manas. While debtors were reluctant to lose control of their firms, banks were hesitant to enter the business of company management, even on a temporary basis.

Random Bailouts. In addition to and independently of the company rescue law, there were a series of other rescue operations in the 1980s, most involving direct government intervention. In many of these operations, State-owned banks or Is Bank took the main initiative, often under government pressure. In some cases, State owned enterprises were used as instruments of bailouts. The decision to extend credit to troubled companies was sometimes taken by the Higher Planning Board (Yuksek Planlama Kurulu, YPK), and financing was secured by the Public Participation Fund (KOI).

The main feature of these operations was the absolute absence of objective criteria used to identify companies that were to be rescued. There were no detailed public pronouncements on how rescue decisions were taken, or why a particular financing package was preferred to another. In that sense, random rescue operations were even worse than the company rescue law. Ultimately, random rescues have been seen as reflections of narrow political calculations rather than a systematic effort to promote efficient restructuring.

Distressed Firms in Priority Development Regions (PDRs). For (public and private) firms in the PDRs, policy makers tried to develop a more concerted strategy. The problems of these enterprises were assessed in a report by the State Planning Organization, dated 1990. These enterprises were promoted as part of a regional development effort that provided substantial fiscal and financial subsidies, without sufficient project screening, monitoring and enforcement of performance criteria. As a result, many of these enterprises are not viable at competitive product and factor prices.

According to the report, many private companies had locational problems. They were either far away from suppliers of inputs, or their operations were predicated on the completion of other public investments which were discontinued. Others either did not have

access to working capital, or were not viable at the prevailing interest rates. In some sectors (e.g. flour and meat processing) incentives resulted in the establishment of too many firms and excess capacity. Similarly, projects in the public sector were also initiated with inappropriate locational and technological choices. Many did not have access to inputs. Product quality was low. Sales units were incapable of responding to changes in patterns of demand. In many cases, projects were discontinued; machinery and equipment purchases were not made, only the construction of buildings were completed.

One solution towards these firms has been advanced by the Turkish Development Bank (TKB). The solution envisaged the establishment of a Priority Development Region Fund, to be managed by the TKB, which was to earn a 2% commission on credits advanced from the fund. The TKB also proposes that defaults on the principal and interest on the credits advanced from the fund be treated as losses on the Fund's account, thereby absolving the TKB from any credit risk. Given that in recent years, applications from problem enterprises in the PRD to obtain loans from the Public Participation Fund (also managed by the TKB) have been rejected by the TKB because the applicants have been deemed as too risky, or unviable, the proposal to shift the credit risk to the Fund was a conscious effort to protect the TKB from being exposed to companies that the TKB itself identified as non-creditworthy.

The DESIYAB (now the TKB) also designed a model for the rehabilitation of the so-called workers' companies. The model is noteworthy in that it envisages both financial and real restructuring measures to rehabilitate the companies. However, it also has several important shortcomings. First, the restructuring options that it presents are biased towards the preservation of the companies involved, and against closure or partial exit. Second, even though the model implicitly acknowledges the importance of agency problems and conflict of interests, and therefore proposes

mechanisms whereby the DESIYAB, effectively the primary restructuring agent, would be able to monitor the implementation of the proposed rehabilitation program, the model is nevertheless inflexible in that it aims at preserving the main ownership structure of the enterprises even in cases where creditor banks participate into the enterprise's capital (para. 2.2.4.1). A priori, there is no need to restrict the options available for the restructuring of capital structure. Similarly, regarding the management of the company, the model mentions measures "to support higher management" and rules out, for example, a complete change in management.

Recommendations for an Approach to Industrial Restructuring

Priority Development Regions. The main difficulties of many of the "problem" enterprises in PDRs are structural, and many of these enterprises are not viable at competitive product and factor prices; hence, maintaining their survival is likely to require a continuous flow of subsidies. The first step in any attempt to restructure the companies in the PDRs is to de-couple the restructuring problem from the regional development or employment problem. The value of an additional job in the region, and the subsidy that it deserves, should be established independent of the cost of restructuring. Then, the desirability of different forms of restructuring, and their costs and benefits, need to be calculated, given the formulated subsidies.

All options of restructuring, relocation, reorganization, exit, (and even doing nothing) should be explicitly considered before choosing the desirable action. Enterprises that are calculated to be unviable even when developmental subsidies are taken into account need to be closed down, and their assets sold. Such enterprises are unlikely to have any positive developmental impact in the PDRs. Any attempt to rehabilitate them would only raise false hopes and cause eventual disappointment. In effect,

such efforts will hinder, rather than promote efficient restructuring.

Who should act as the restructuring agent of these enterprises? The identity of the restructuring agent is less important than the principles that it should follow. First and foremost, the restructuring agent should have a stake in the restructuring process. In other words, the agent should share in the risk of restructuring and bear the credit risk of any financing that it provides. Second, the agent should take the subsidy parameters as given; it should not take part in the formulation of subsidies.

Restructuring options for non-priority regions. With respect to the economy as a whole, random rescue operations should be eliminated, since they simply generate unwarranted unequal competition. Outright subsidies for rehabilitation should also be ruled out, and restricted to explicit developmental goals. The question of whether a distressed company deserves any additional support should be left to creditors. Instead, an approach that focuses government intervention directly on market imperfections is needed. There are two critical areas that deserves the government's attention.

The first relates to financial resources. Governments' attempts to encourage the banking system to play a major role in restructuring, as was the case in the Company Rescue law, has so far failed in part because commercial banks lack the expertise and willingness to participate in or take over enterprise management. Banks are also constrained by recent banking regulations that limit equity participations. This reluctance to assume control rights of enterprises makes banks also unwilling to finance risky restructuring activities.

One solution would be to promote market agents that specialize

in company workouts. Such agents have two sets of skills. First, they have sectoral expertise, that is, they either contain, or have access to expertise on appropriate technology, product mix, marketing skills, and export opportunities. Second, they have financial engineering capabilities, enabling them to negotiate agreements between creditors and debtor companies in need of restructuring. Moreover, they perceive the restructuring activity as a source of profits; they either provide their services against a fee that is tied to the success of the restructuring, or they temporarily assume the ownership of the enterprises with a view to sell them, in a reorganized form, at a profit. In both cases they have a stake in the company to be restructured. Such agents may be hired by the main creditors who delegate to them the monitoring and control functions that are necessary to deal with the agency problems discussed above. The activities of Tekstil Holding, established in recent years with equity capital from TKB, is a model worth studying in this respect.

Such agents that specialize in corporate workouts often engage in informal reorganizations, without getting involved in a legal bankruptcy procedure. Outcomes of informal reorganizations, however depend critically on the nature of bankruptcy procedures. Bankruptcy reorganization procedures complement informal reorganizations. In Turkey, formal reorganizations are governed by the section 12 of the bankruptcy law (Icra Iflas Kanunu), which stipulates a concordat process for firms. However, the law is outdated and has not benefitted from substantial reforms in international bankruptcy laws over the last decade. Reforming the legislative framework for the concordat process would substantially improve the policy environment for restructuring.

Most random bailouts in Turkey have been and are being carried out without any serious feasibility studies. Resources spent for these operations would have been used much more efficiently if they financed first of all the production of such studies. Production of

information about the viability of firms in need of restructuring is essential for efficient decisions, as well as for raising the necessary finance (especially from private financial institutions).

The second critical area relates to labor mobility. Concerns with unemployment or its political consequences have often delayed or otherwise hindered efficient restructuring. In general, labor mobility may be enhanced through unemployment compensation schemes, and job placement and retraining services. Once these measures are taken, and cost of unemployment to workers adequately addressed, the restructuring options can and should be decoupled from the unemployment question. The proposed unemployment insurance scheme, currently under discussion, is a step in the right direction.

Restructuring of State economic enterprises (SEEs) may present special problems. In some cases, closures of SEEs are likely to have serious regional implications, as would be the case, for example, with coal mines in the Zonguldak area. In the event of such closures, displaced workers are not likely to find job alternatives in the same region. In such cases, unemployment compensation schemes may be supplemented with regionally targeted public programs that increase the productivity of private investments in the region.

In order to generate benefits that can be sustained over time, restructuring of public enterprises often requires fundamental changes in the way they are managed. In the case of Turkey, as in many other developing countries, public enterprises face two types of managerial problems. First, enterprise management lacks autonomy from political influence. Employment and investment decisions are critically influenced by political considerations. Second, the management of public enterprises are rarely held accountable for the competitive performance of enterprises. These problems are both among the major causes for the poor performance of public enterprises, and hence for the need for restructuring,

and among the major barriers that hinder restructuring. The most efficient way to solve these problems is privatization. Absent privatization, mechanisms that establish accountability and autonomy are required. These mechanisms should both link managerial reward to performance, and enable the monitoring of performance against clearly formulated performance criteria.

VII. COMPETITION LAW AND ITS RELEVANCE FOR TURKEY

Mark Dutz
The World Bank

The process of deregulation and the increasingly free-market orientation of the Turkish economy over the past twelve years is having an important impact on the degree of competitiveness of the economy. As remaining government controls and regulations are reduced and the economy relies ever more on market forces to allocate resources, the benefits to the Turkish economy of enacting a competition law are becoming more obvious. While a new Draft Law has been written recently, it requires too many fundamental changes to be supported as part of a viable, ongoing process. The current effort to introduce a competition law in Turkey should be replaced with a completely new initiative that attempts to take into account the views of all major players in the Turkish economy, including business. Rather than introducing an amended version of the existing draft law to Parliament, it is recommended that a new process be initiated that relies heavily on lessons from other countries regarding what is likely to work and not work within the broader Turkish environment.

Competition law is a legal code which governs economic relations by defining the "rules of the game" in the business arena, related to conditions of competition in the marketplace. Unless specific exemptions are provided, the law applies to all sectors of economic activity within its geographic boundaries, including both private and state-economic enterprises (SEEs). The legislation itself generally defines the types of conduct and transactions that are deemed undesirable (that do not promote the goals of the law), describes the relevant penalties, and provides an institutional structure to enforce its prohibitions.

Appropriately designed competition laws can play an important role, complementary to liberal trade policies, in maintaining well-functioning, competitive markets. In addition, such laws also can be instrumental in creating more competitive markets, through their impact on the existing and future structure of markets.

By creating and maintaining a more competitive and predictable environment, competition law is in the interest of most enterprises and all consumers, both industrial users of the outputs of other, upstream enterprises as well as final, end-use consumers. Through the exercise of monopoly power, a small number of enterprises can control scarce resources, block entry, restrict purchases or sales on the domestic market, and thereby raise domestic prices. While specific enterprises may be dominant in certain markets today, they may be victims in other markets or be on the losing side tomorrow. Small or large private enterprises also may be disadvantaged through unequal and preferential treatment received by state-owned enterprises. Without clear rules regarding what type of market behavior is definitely unacceptable, both today's and tomorrow's victims would have no recourse. It is important to stress, though, that the rules are intended to strengthen market forces rather than to interfere or regulate too much; just like the referee's role in a soccer game, the competition rules work best when they provide a predictable framework with minimal intervention. Rewards from entrepreneurial effort and skill are then easier to predict.

The increased globalization of goods and services markets provides another compelling argument in favor of the adoption of a competition law for Turkey. With Turkish enterprises increasingly operating in foreign markets, a national law in harmony with EC competition law will help Turkish enterprises adapt to internationally accepted norms of business conduct. Whether or not Turkey joins the EC, Turkish enterprises would benefit abroad and become stronger international competitors if forced by their domestic environment to be stronger competitors at home. In the

event of Turkish membership in the EC, a Turkish competition law would both increase business certainty and help in the administration of the law to have a compatible domestic and international law. However, the main argument for instituting a competition law in Turkey should not rest on EC membership. It should be based on the economic benefits to society at large from greater competition and a more predictable environment in the home market.

Turkey's domestic industrial structure is fairly concentrated by international standards. In addition to having fairly high levels of concentration in the domestic production of individual industrial products, ownership of productive assets across product groups is concentrated through the predominance of a few large industrial holding companies and associated banks. Many of these large private holding companies also control the country's largest financial institutions. However, the more relevant criteria to assess the level of competitiveness in the domestic economy include the amount of rivalry between enterprises in specific markets, the extent to which consumers face separate choices and sellers of goods or services make independent offers, and the degree to which barriers prevent new sources of domestic or foreign supply from entering local markets. Another critical issue affecting competition is the degree to which those SEEs that operate in markets together with private enterprises receive special, discriminatory treatment.

Within the prevailing economic environment in Turkey, it would be desirable to have a legal framework to strengthen market forces, to create both more business certainty and a standard of business morality that is compatible with international practices. The logic underlying such a competition law should be geared to changing perceptions regarding what types of conduct conform to internationally acceptable norms of doing business, and what types of conduct are unacceptable because they create major damage to the

public at large.

The challenge for Turkey is to build a set of competition rules and an accompanying enforcement institution to accomplish this task. Competition law and its enforcement should be crafted to keep possibilities of abuse of its intended objectives to a minimum. A variety of approaches to insulate the enforcement process from external pressures exist. It does not appear to be desirable, for example, to import the full set of competition laws at the disposal of a typical Western European country, of Canada, or of the United States. At the onset, to allow for gradual institution-building in an environment where conflicting pressures are likely to be brought to bear on the competition authorities, it is preferable to focus only on a very few measures and strive to enforce those very well. The key elements of a Turkish competition law should include: a clearly stated objective; the explicit use of competition law as an instrument of overall government policy; rules on cartel agreements, abuse of dominant position and mergers that are used only sparingly at first and limited to instances of gross misconduct; and rules for a well-financed, professional and independent administrative structure.

Experience from other countries that have successfully introduced or modified their own competition law suggests that the process generally takes time, and should begin with one or more studies on prevailing market structure conditions and on the merits and disadvantages of different forms of competition legislation in relation to the national context. Once a clear understanding exists of the important and distinctively Turkish features of goods and services markets, the next step is to specify clearly what the objective of the law should be. To the extent that the law attempts to promote objectives supplementary to economic efficiency, the risks of inconsistent application increase. It is therefore desirable to restrict the objectives of competition law, or at least make them as explicit as possible, both in their

definition and ranking.

The role of promoting competition in government policymaking, at the local and national level, should be articulated explicitly in Turkey's competition law. In this way, competition principles can be incorporated more broadly and systematically in government policymaking. Ideally, competition policy should be viewed as the fourth cornerstone of government economic framework policies, along with monetary, fiscal and trade policies.

In this context, it would be desirable to announce how conflicts between the promotion of competition policy objectives and other public policy objectives will be resolved, to ensure consistency in government decision-making and thereby reduce business uncertainty. For example, where barriers to entry are the result of decisions or actions by other State administrative authorities that discourage competition, the Turkish competition authorities should have the authority to seek immediate suspension of the undesirable action ("cease and desist"), pending resolution of the conflict through specified channels. Importantly, the competition authorities should be empowered to intervene in regulatory and trade related matters. They should receive notice and provide comments on proposed policies and rules of other State policymaking bodies. More generally, they should have the authority and mandate to prepare submissions and make presentations whenever decisions of other State policymaking bodies appear to be limiting competition on domestic markets.

Where entry barriers are the result of actions by private enterprises or SEEs, the competition authorities should have access to necessary resources from the State budget to undertake background analysis, document their findings, and seek to lower or remove such barriers. This overall function of helping to create conditions for markets to be more contestable should be regarded as one of the most important roles of any competition authority.

In addition to reducing entry barriers and being a loud voice for competition throughout the country, the Turkish competition authorities should encourage sellers in the same domestic market to make independent offers for the business of buyers. Cartel formation and price fixing, for example, should be regarded as theft, as morally unacceptable practices. To help deliver this message clearly to the business community, prohibitions on restrictive agreements between enterprises should differentiate clearly between horizontal and vertical agreements. Horizontal agreements to fix prices on a collective basis, to divide patterns of distribution along rigid and exclusionary patterns, or to agree on allocation of markets should be unambiguously (per se) illegal. Turkey should consider following the example of several Western market economies which provide for very tough penalties, including heavy fines and possible imprisonment against individuals who engage in such horizontal agreements. To avoid alarm yet emphasize the importance attached by the authorities to deter horizontal agreements, criminal sanctions could be subject to a gradual phase-in.

On the other hand, vertical agreements generally should not be prohibited, except when competition is significantly limited. Since it is very difficult to distinguish between those vertical agreements that are harmful and those that are beneficial, it is recommended <u>not</u> to use scarce enforcement resources in controlling vertical agreements for the foreseeable future.

Regarding the prohibitions against abuse of a dominant position and merger guidelines, it will be very important to include sufficiently clear definitions of the concepts of analysis, as well as subsequent guidelines, to reduce business uncertainty regarding the interpretation of these aspects of the law. The merger control rules, for instance, should specify the information to be included in notifications, the time allowed to the agency for analysis of the proposal, and the criteria that the agency should

use to evaluate the cost-benefit tradeoff of proposed transactions. More generally, the wording of the prohibitions should remove any uncertainty that large enterprises may be persecuted exclusively based on their size or dominance in a market. There is nothing inherently wrong about a monopoly position obtained and maintained through offering consumers higher quality products at lower prices than are available from other suppliers. Whether or not an enterprise is designed as being dominant or as having monopoly power should depend on a careful analysis of factors such as the availability of alternative products available to consumers and the likelihood of entry from foreign suppliers or new domestic ones.

The development of Canada's new competition law is instructive in this regard. Many people argued that, as a small open economy, Canada needed enterprises with a large absolute size to achieve economies of scale or to compete with large foreign manufacturers. This thinking is reflected throughout the new Canadian law, which is intended to maintain and promote competition in order to "expand opportunities for Canadian participation in world markets, while at the same time recognizing the role of foreign competition in Canada." The new law, for example, forbids the authorities from stopping a merger solely on the basis of evidence of concentration or market share; the law also has exemptions for mergers that are efficiency-based or that are formed for specific research and development activities. Turkey may wish to consider such exemptions, which create certainty by clearly defining precise areas where prohibitions do not apply.

In its role as competition advocate, the Turkish competition authorities would have to ensure that all other State administrative authorities do not unduly restrict competition. In addition, in their control of horizontal cartel agreements, it would be desirable that SEEs and private enterprises be treated equally. To perform these and other functions in an objective and transparent manner, it is critical that the competition authorities

should have a clearly defined investigative mandate, and remain autonomous and independent from other State bodies. An undesirable conflict of interest would arise if the competition regulating body were merged with one of the regulated bodies. Therefore, it is desirable that the competition authorities be completely independent from other government Ministries.

In the context of Turkey, the organizational structure is perhaps the most important aspect that would contribute to the effectiveness or failure of the law, since it will affect how the law would be implemented. The current proposed structure, with investigative and adjudication functions not clearly separated, and subordinate to a weak Ministry that may choose an interventionist approach just to make itself heard, appears to be a recipe for failure. Budget independence, very high qualification standards for personnel, and single terms for perhaps a smaller number of Commissioners all seem essential. It is desirable both for the adjudication decisions to be subject to review, to create checks and balances consistent with the general setup of democratic systems. Ideally, the competition authorities responsible for the investigative function should be located in an independent agency, with investigations being confidential and undertaken behind close doors. A separate specialized Court would be responsible for the adjudication function, with transparent hearing subject to business confidentiality considerations and with a transparent review and appeals process to guarantee that corporate rights would not be abused.

If an independent agency together with judicial enforcement are not found to be feasible in the current Turkish context, an alternate hybrid approach may involve locating the competition authorities under a strong Ministry while maintaining a clear separation between investigative and judication functions. With such pure administrative enforcement, adjudication would be rendered by a separate quasi-judicial body subordinate to the

Ministry, with no judicial review at all. To hold the power of the Minister in check, appeals to Cabinet should be permitted and the Cabinet should have veto power. It is important to choose a strong Ministry whose mandate in other areas does not conflict with the promotion of competition and does not prevent sound, independent judgements from being made; if, for example, the Ministry of Economy were also responsible for tariffs or the Ministry of Industry were also responsible for subsidies, these would not be desirable choices. Finally, it should be stressed that, in a concentrated economy, subordination of all functions to a ministry risks undermining freedom of economic action and democracy by creating a direct channel of preferential access for entrenched business interests that are closely aligned to the political parties in power. A very careful study seems warranted to determine what type of judicial or administrative enforcement is appropriate. Such a study should take into account Turkey's experience with existing judicial and administrative bodies, and should determine whether an independent agency along the Italian model or a well-funded, competent Special Court are workable within Turkey.

Establishing a new code of business morality takes time, and there are major risks that the process itself would be diverted away from its intended objective. To build a consensus in support of such a law, the preparatory phase should serve an important educational function stressing the benefits of competition and a more predictable business environment for the country as a whole. If the objectives and content of the law are not well publicized by its date of enactment, it would be important to allow for a transitional period, so that conduct that was morally accepted and legal does not become immoral and illegal overnight.

VIII. ANTIDUMPING AND ANTISUBSIDY POLICIES IN THE TURKISH CONTEXT

Patrick A. Messerlin
Institut d'Etudes Politiques de Paris

In June 1989, Turkey adopted the law "on the prevention of unfair competition in importation" containing both antidumping and antisubsidy provisions. This was part of a general move among major industrializing countries: Korea (1985), Mexico (1986) and Brazil (1988) have also introduced such rules. More importantly for its trade relations, Turkey which has initiated 54 antidumping cases since 1989, is not alone in the region to implement such rules: since the 1970s, the EC has been a heavy user of antidumping regulations, with 16 antidumping actions against Turkish exporters since 1980 --a third of them in 1990.

The Economic Rationale for Antidumping and Antisubsidy Laws: The Search for a Rare Bird

The economic rationale for antidumping and antisubsidy laws is limited to well defined situations --most of them unlikely to be often found in the real world.

The economic rationale for antidumping laws covers exporters' practices of "price discrimination" which consist in selling goods on export markets at a price lower than the price charged on the exporter's domestic market. Or, dumping refers to "predatory" strategies whereby a foreign firm charges a low price for its products in the importing market in order to drive out of business the existing domestic firms of the importing country and --afterwards-- to enjoy monopoly rents in the importing market.

Economic theory shows that there are no robust reasons for taking antidumping actions in cases of price discrimination which merely mirrors the fact that foreign exporting firms have a market power in their domestic markets higher than in the foreign markets. By contrast, it shows that predatory strategies should be contained, as any anti-competitive behavior --implying that antidumping laws should be a mere extension of competition laws and that they should be based on the same objective of consumers' welfare.

Economic evidence suggests that price discrimination strategies are frequent. In all countries, prices differ between regions (or even stores) by more than the differences which could be attributed to transport and transaction costs. By contrast, it shows that there are very few cases of predatory pricing (less than a handful of cases in the U.S. during the last century).

The economic rationale for antisubsidy laws is thin as well. Foreign subsidies represent transfers from foreign governments to the buyers of the importing country. These transfers are positive if the resources in the importing country are perfectly mobile. If foreign subsidies impose a costly relocation of resources in the importing country from one activity to another, the transfers of foreign subsidies are net of the adjustment costs in the importing country. To address adjustment problems by taking antisubsidy measures at the product level (by imposing duties on the product price) is likely to be a worse solution than to take measures aiming at enhancing factor mobility.

Do the existing antidumping and antisubsidy laws serve the rationale evoked? As all these newly adopted laws follow GATT rules, the answer is provided by looking at the economic soundness of GATT Article VI. As this Article defines dumping as price discrimination, GATT-consistent antidumping laws fit with the wrong economic argument for antidumping. Moreover, they constitute an imperfect instrument for dealing with predatory pricing since they could not condemn a predator who would lower

its price simultaneously in its domestic and export markets in order to eliminate the domestic producers of the importing country. Concerning subsidies, GATT texts allow measures which "countervail" foreign subsidies at the product level (such as countervailing duties imposed on the product price) --favoring thus an inefficient management of adjustment problems.

Antidumping and Antisubsidy Laws: An Instrument of "Predatory Contingent Protection"?

As GATT-consistent antidumping and antisubsidy laws are not based on sound economic motives, their adoption raises three questions. What is the real purpose of these regulations? What are their major effects on the economic activity of the countries implementing them? Lastly, what is the "efficacy" of these regulations --that is, their ability to achieve their declared goals?

The section answers these questions by focusing on the EC rules for two reasons: the EC is the main trading partner of Turkey; the EC rules have deeply inspired the Turkish antidumping and antisubsidy laws and the EC antidumping or antisubsidy cases against Turkish exporters provide an excellent illustration of the points to be examined. Among the OECD countries, Australia, Canada and ---above all--- the U.S. are also heavy users of antidumping and antisubsidy rules. Japan and EFTA countries are the exceptions: they have no such laws or they do not implement them. That the EFTA countries will join the EC will reduce this small group of Japan. The number of developing countries adopting such laws is steadily increasing: a handful in 1990 (including Turkey), a dozen in 1992-1993 (Argentina, Costa Rica, Hungary, Morocco, or Tunisia having or being on the verge to join the club of the countries implementing post-Tokyo Round antidumping or antisubsidy regulations).

The Purpose of GATT-Consistent Antidumping and Antisubsidy Laws: From Protection to Protectionism?

The rationale behind GATT-consistent antidumping (and antisubsidy) laws flows from the condition imposed by GATT Article VI:1 for taking antidumping (and antisubsidy) actions:

> "The contracting parties recognize that dumping [...] is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party [...]."

The real purpose of GATT-consistent antidumping (or antisubsidy) laws is thus the <u>protection</u> of the import-competing domestic industry.

Is it possible to go further and to suggest that the GATT texts favor a drift from protection to <u>protectionism</u> (that is, a systematic attitude of protection)? Two opposite forces are to be considered. On the one hand, the GATT texts do not impose to contracting parties any obligation to take antidumping (or antisubsidy) measures. Rather, they suggest that a country should rely on its own conviction that freer trade is better than protection from its own point-of-view. On the other hand, the GATT texts favor a drift to protectionism because they take the narrow view of the domestic producers' interests and do not mention the wider interests of the industrial users or consumers of the imported good allegedly dumped. By not providing the legal background for incorporating a sound balance between the interests of the producers and consumers when deciding to protect or not an import-competing industry, the GATT texts make difficult the implementation of internal disciplines by each country.

GATT Article VI:1 imposes a format common to all antidumping laws which is based on four elements: the initiation of an investigation based on an industry complaint; the determination of dumping by foreign exporters; the determination of the injury suffered by domestic firms; and the proof of a "causal link"

between dumping and injury. In most of the countries, this format has been developed in a quasi-judicial procedure in four steps.

First, antidumping action are initiated by the public authorities in charge of the investigations upon complaints lodged by domestic firms. As a result, domestic firms are the de facto real initiators of antidumping cases because the only conditions imposed at this stage are minimal: the complaining firms should represent a "major proportion" of the industry and they should have provided "enough" evidence about the existence of dumping and injury. The "major proportion" condition generates a crucial bias: it favors complaints lodged by domestic sole producers or colluding oligopolies. For instance, two out of the 9 EC antidumping cases (for which there is available information) initiated against Turkey were initiated by sole EC producers (ferro-chromium and glass) and five other cases were initiated by half a dozen large EC firms which were enjoying a joint dominant position in the EC markets.

Second, the investigating authorities determine whether there is dumping and --if so-- they calculate the margin of dumping. That price comparisons are notoriously difficult imply that rules of comparison are essential, and that biased rules of comparison can show dumping where there is no dumping. The most remarkable bias is that transactions where export sales at prices above the domestic price of the exporter are excluded by most of the investigating authorities for determining the existence and extent of dumping --making almost certain the finding of dumping. All the Turkish firms caught in EC antidumping cases have faced this problem because the EC authorities systematically enforce this biased rule. Another source of biases is the treatment of vertical links between foreign firms, as best illustrated by the 1986 EC polyester fibers antidumping case where transactions between Turkish producing and sales firms were not considered by the EC Commission as "transactions between unrelated parties" --leading the Commission to the conclusion that "it is only the sales prices of the sales companies to their customers that can

be relied on to reflect the true normal value of the product". Moreover, all the biases on price estimates are compounded by the fact that the antidumping authorities do not feel obliged to assess price differences in terms of sound economics. For instance, the fact that the allegedly dumping firms often hold small market shares of the importing country market has not stopped the EC Commission to take actions. The initial market shares held by all the allegedly dumping firms in cases involving Turkish firms range from 0 to 9.6 percent of the EC consumption --with an average of 3.2 percent.

Third, the determination of injury to domestic firms is based on a series of criteria, the most frequent of which are: increases of import market shares held by the foreign firms; decreases of the domestic consumption market shares held by the EC firms; and the fact that foreign firms "undercut" EC prices on EC markets. None of these criteria makes robust economic sense and each of them can be illustrated by amazing examples of captured rules.

Lastly, antidumping measures can take two main forms: duties (*ad valorem* or specific) or undertakings --that is, the commitments by the foreign firm to raise prices to a minimum level or decrease exports to a maximum level. In other words, undertakings consist in voluntary export restraints or voluntary price increases. That undertakings represent half of all the measures taking by the EC Commission (only one fifth of the cases involving Turkish firms for which the final outcome is known) is a fact to confront to the fact that both instruments are inconsistent with GATT rules.

Antisubsidy actions are similar to antidumping actions, except that they directly involve the State authorities of the exporting firms in the procedures --leading to more cumbersome and much more politically difficult discussions. As a result, antisubsidy actions tend to be much less frequent than antidumping actions (except in the U.S. trade policy). For

instance, there have been only a dozen of EC antisubsidy cases, to be compared to roughly 450 EC antidumping cases between 1980 and 1992. How then to explain that Turkey has been the major target of these few EC antisubsidy actions? It seems that these actions against Turkey send a political signal more that they convey effective measures because --so far-- the EC has only applied antidumping measures on Turkish exports.

The Effects of Antidumping Actions on the Import-Competing Sectors

What have been the major effects of this instrument on import-competing sectors? Three effects can be observed: antidumping measures have restricted imports from the allegedly dumping countries; they have created substantial trade diversion; and they have increased domestic prices in the importing country.

The most remarkable aspect of all these effects is their large magnitude which is due to the fact that antidumping barriers are frequent and high. For instance, roughly 70 percent of the antidumping actions initiated by the EC Commission have been terminated by restrictive measures (duties, undertakings or a mix of both) and the average *ad valorem* tariff equivalent of these measures is roughly 23 percent. Turkish exporters caught in EC antidumping actions face an average antidumping *ad valorem* tariff equivalent of roughly 18 percent (including undertakings).

As a result, import quantities from the allegedly dumping countries drop drastically, as illustrated by the EC history of antidumping. The first year after the initiation of the case (at a time when definitive measures are generally still unknown) imported quantities have decreased --on average-- by 18 percent. Three years after the initiation, they have decreased by 35 percent, and two years later, by 50 percent.

Antidumping actions are discriminatory by nature: they deal only with a portion of the imports of the considered product. The

extent of trade diversion depends on the existence and efficiency of alternative sources of supply. For instance, extra-EC imports from "non-dumping" countries have increased by 30 percent three years after the initiation, and intra-EC imports have increased by 15 percent. Both figures suggest a substantial trade diversion in favor of the EC and foreign competitors of the allegedly dumping countries.

Lastly, the impact of antidumping measures on the prices in the importing market is the combined result of import restrictions, trade diversion, market structures in the importing country, and the type of antidumping measures taken. The EC experience suggests that trade diversion is less pronounced in the case of exporters from less developed and newly industrialized countries which seem less able to increase their prices (in relative terms with respect to prices charged by EC producers) than exporters from industrial countries. It also shows that the increase of domestic prices is more pronounced in the cases with undertakings and mixed measures than in the case with ad valorem duties.

The "Inefficacy" of the Antidumping Measures

The proponents of antidumping laws often justify the use of this instrument by the fact that dumped imports threaten the capacity of domestic firms to adjust to foreign competition. Is there any evidence supporting this justification? Two facts strongly suggest that the declared goal of adjustment is not achieved.

First, antidumping cases are lasting for long periods. This is true even when antidumping regulations --as in the EC-- include a "sunset" provision, meaning that cases are to be systematically reviewed after five years and that measures are to be terminated if there is no more dumping. Despite this sunset clause, EC antidumping cases initiated since 1980 have lapsed on average roughly eight years.

Second, case studies reveal the huge gap between the adjustment targeted and the adjustment achieved. A wellknown example is the U.S. antidumping case on TV sets which has been imposed in 1982: nine years later, the U.S. industry is completely dominated by foreign firms (most of them having been involved in the antidumping case). The U.S. steel sector offers a similar example.

How costly for the importing economy are such "inefficient" antidumping measures? Among the many elements to be taken into account, there is one aspect which deserves special attention -- particularly by countries characterized by small domestic markets. There are strong links between anti-competitive behavior and antidumping actions. For instance, half of the cases for infringement to EC competition rules (Article 85:1 of the Treaty of Rome) are accompanied by antidumping actions.

The Turkish Antidumping and Antisubsidy Law

Has the antidumping and antisubsidy Turkish law the same biases than the typical GATT-consistent laws examined above?

The essential provisions of the Turkish law are not very different from the provisions included in the existing antidumping and antisubsidy laws of other GATT contracting parties, in particular the EC. The Turkish law introduces a quasi-judicial system based on the GATT format: initiation, determination of dumping, injury and causal relationship. This initial observation suggests that the enforcement of the law is likely to have the same negative impact on the Turkish economy than the other GATT-consistent antidumping laws.

However, the Turkish antidumping law has certain specificities which deserve some attention. The most important specificities a e concentrated in the first (initiation) and last (adoption of measures) steps of the procedure.

At the initiation stage, the Turkish law (Article 3) adds a third reason for taking antidumping measures in addition to material injury and to threat of material injury: the "impairment of the market." The law and the subsequent regulations do not elaborate on this notion so that one is left to the interpretation which will emerge in actual cases. Moreover, Article 4 introduces two specificities. It does not require that complainants constitute a "major proportion" of the industry. It introduces an ex officio clause allowing Turkish authorities to lodge a complaint in the absence of complaints lodged by domestic firms.

Concerning measures to be taken, the Turkish law contains one potentially more liberal clause and three more protectionist provisions than comparable laws. Article 7 introduces the "lesser-than-margin of dumping" rule by which the antidumping (antisubsidy) measure can be lower than the estimated margin of dumping (subsidy) and based on what it is necessary for eliminating the injury (as in the EC rules). Among the more protectionist provisions, Article 11 officially recognizes that undertakings consist in voluntary export quantity restraints or in voluntary price increases. Article 12 introduces an "inverse" "national interest" clause. Normally (as in the EC) the national interest provision allows the authorities not to take measures in the "interests of the nation" --even if dumping and injury have been established. By contrast, the Turkish law defines the national interest as a situation where immediate intervention under the form of (provisional) measures is required. Lastly, Article 13 of the Turkish law does not systematically exclude the possibility to concurrently enforce antidumping and antisubsidy duties, and it adds that when it is not the case, the duty with the higher rate shall only prevail.

This examination of the Turkish law would be incomplete without a description of the institutions in charge of the procedure. Turkish antidumping cases are carried out exclusively by administrative bodies -a board in change of the investigations

and of suggesting measures, the General Directorate of Importation which is the secretary of the Board, and the Ministry the General Directorate of Importation is attached to. The organizational chart is similar to the EC organization --based on the Commission and Council. It is thus likely to be as biased in favor of import-competing firms as the EC institutions --since it presents the same lack of transparency and appeal in case of litigations.

It has been noted that this organization could create tensions within the legal Turkish system. On the one hand, the bodies involved make the whole antidumping process falling under the ambit of the Turkish administrative law. On the other hand, the antidumping procedure has to respect time constraints (in order to allow its quasi-judicial aspects to be developed) which have to be more generous than the time constraints which should be respected under the general Turkish administrative law (under this law, any dispute should be solved within 60 days after the complaint).

The Turkish Antidumping Cases: A Preliminary Assessment

The Turkish antidumping and antisubsidy law and regulations entered in force in October 1989. It is too early to get a clear picture of the impact of these rules on the Turkish economy. Moreover, they can be an instrument of retaliation against EC antidumping actions initiated against Turkish firms. Or they can be an instrument used by Turkish <u>and</u> EC firms in order to protect the Turkish markets against foreign exporters --for instance, they can duplicate EC antidumping cases against exporting firms from non-EC countries. Lastly, the strong anti-competitive content of antidumping actions can lead EC firms established in Turkey to initiate Turkish antidumping actions against <u>other</u> EC firms exporting to Turkey.

<u>An overview of the cases</u>. Since December 1989, 54 cases were initiated by the Turkish authorities. This record is impressive,

more especially as the outcome of 50 cases is already known --meaning an average time span of 10 months by case.

The time pattern of the cases shows an upsurge of cases in the first two years and a lower rate of initiation since 1991. This time pattern may be related to the initially high level of expectations raised by the adoption of the antidumping law which may have been affected by a relatively low "rate of restrictiveness" (that is, the number of cases terminated by restrictive outcomes as a percentage of the number of cases initiated with a known outcome) of two-third for the cases initiated in 1989 and less than 50 percent for the cases initiated in 1990 and 1991.

The breakdown by country shows two similarities and dissimilarities with the EC antidumping record. The similarities are the high percentage of "non-market economies" and of Asian newly industrialized countries --with a strong focus on China (RP) and Taiwan-ROC. The dissimilarities between the Turkish and EC antidumping records concerns Japan --so far never caught in Turkish antidumping cases while it is a prime target of the EC procedure-- and the substantial percentage of less-developed countries --Egypt, India, Indonesia, and Pakistan are caught in several Turkish cases, whereas they are quite ignored by EC antidumping cases.

The breakdown by industry is the most important because protection is driven by domestic industries (not by the desire to target foreign countries). The 54 cases cover a wide range of industries --perhaps mirroring the fragility of the recent free trade orientation of the Turkish economy. The most active industries have been related to textile (ISIC 3211 and 3513), metal products (ISIC 3819) and scientific equipment (ISIC 3851). The rate of restrictiveness shows that some Turkish complaining industries --synthetic chemicals or machinery-- are much more "successful" than others.

A more detailed examination of the Turkish cases suggests more problems. However, the number of available cases is yet so limited that observations should lead to questions, rather than to firm conclusions.

As the Turkish law has no constraint on the definition of industry, it is impossible to know whether the complainants represent a major proportion of the industry, whether they are Turkish firms or foreign firms established in Turkey --that is, to have some evidence on the impact of the antidumping cases on the level of competition in the Turkish markets.

The enforcement of the Turkish antidumping law has shown wide variations in the notion of the "like-product" imposed by GATT Article VI. In particular, there are a substantial number of cases which cover products defined at the six or even four digit level of the trade classification. To extend the definition of the like-product to a group of goods defined at the four digit level of the trade classification represents a massive increase of the trade barriers.

There is a large and increasing number of cases in which the Turkish investigating authorities have used constructed values, and worrisome methods deserve some attention, as best illustrated by the three glass cases against Romania, when the Turkish authorities used Greek prices --despite regulated prices and other known problems. As in the EC history of antidumping, there is a positive correlation between the use of constructed estimates and the frequency of restrictive outcomes.

The material injury clause does not seem enforced in a more sound manner than in the EC history of antidumping. Import surges are --by far-- the dominant motive. Moreover, this criteria seems increasingly dominant --other criteria such as the evolution of domestic production or stocks are less often evoked in the most recent cases than in the first cases. Moreover, lower import surges are observed in the most recent cases.

Conclusion

The Turkish antidumping and antisubsidy law is based on the same wrong premises as other GATT-consistent antidumping and antisubsidy laws. As these laws, it is biased in favor of protectionist outcomes which may endanger the liberalization policy Turkey has followed in the 1980s.

Turkey may also illustrate the syndrome of "fatal attraction:" many Turkish cases (between one third to one half) concern the same goods and countries as the EC cases (as many Mexican cases are similar to the U.S. cases). Moreover, the evidence available for the two cases initiated in 1989 and terminated in 1990 by antidumping measures (polyester fibers) suggests the same impact on the Turkish import-competing sectors as the impact described for the EC: in particular, strongly declining imports for countries on which antidumping measures have been imposed and substantial trade diversion in favor of other exporters (including countries included in the cases but not subject to measures).

What can it be done? The Uruguay Round clearly shows that better disciplines in antidumping cannot be expected from an international agreement. As a result, there is no other way than an unilateral improvement of the antidumping rules. A compromise between economic arguments and political sensibility could be achieved by using a sound version of the "national interest" concept --that is, by imposing to the authorities the obligation to take into account the interests of the users and consumers (as well as the interests of the domestic producers) and by making explicitly possible not to adopt antidumping measures which would impose costs on the Turkish economy higher than the benefits they grant to domestic interests.

IX. CONDITIONS OF COMPETITION AND DETERMINANTS OF COMPETITIVENESS: THEORETICAL CONSTRUCTS VERSUS EMPIRICAL EVIDENCE

Helmut Forstner
UNIDO

In every analysis or discussion of competition policies reference is usually made - either explicitly or implicitly - to the notion of perfect competition. The optimal properties of general equilibrium under perfect competition make that form of competition an ideal benchmark against which real-life performance of markets can be evaluated. The major point here is that markets in a perfectly competitive equilibrium allow the price mechanism to lead to overall efficiency in the allocation of scarce resources. Such allocation would satisfy both consumers and producers where no one in the economy could improve their situation without worsening that of someone else. With this background the analysis of competition policy is first of all normative in that it is concerned with the welfare effects of departures from the ideal of perfectly competitive markets.

In reality most industrial markets are characterized by some form of imperfect competition, in many cases for reasons that are beyond the realm of influence of policy measures. As a result, to establish perfect competition in all industries would be a highly unrealistic policy objective. While the achievement of overall allocative efficiency in perfectly competitive markets is beyond the reach of policy makers, there remains another strong rationale for strenghtening competition by appropriate policy measures. This rationale builds mainly on the argument that a higher degree of competition enhances productive efficiency of industries. Recent work in industrial organization can serve to substantiate this assertion by showing that the dangers of imperfect competition, i.e. the exercising of market power by firms, lie not so much in excess profits but in

abnormally high costs. Such results help to shift the focus away from allocative efficiency to productive efficiency.

Implicit in the above shift is a change in the motivation - in particular in the case of industrializing economies - for implementing policy measures that aim at increasing competition. With the new focus on productive efficiency policies for competition become policies for (international) competitiveness. As a consequence they have to be seen in the broad context of policy measures that help to strengthen a country's competitive standing in the international markets.

Thus, if the task is - as in the case of the present chapter - to provide empirical evidence on certain aspects of competition and competition policy, it appears natural to select evidence on international competitiveness, however under different forms of competition. Such evidence can inform the policy maker about likely consequences for international competitiveness - his ultimate target - of measures that are primarily aimed at enhancing the degree of competition in industry.

Like in the analysis of trade policies also in that of international competitiveness much insight can be gained from modelling within the perfectly competitive framework. Based on such models empirical data can be analyzed with the objective of identifying some of the major determinants of international competitiveness. Here the general empirical result is that, although in the real trading world imperfect competition is pervasive, forces that would completely determine international competitiveness under perfect competition have a significant impact in an imperfectly competitive world too.
The classic example here is the role that factor abundance plays as a source of international competitiveness both for the manufacturing sector as a whole and for particular industries within this sector.

Among the results on 'conventional' (i.e. factor-abundance based) determinants of international competitiveness two findings deserve particular mention in relation to policies for competition and competitiveness. The first one is both straightforward and somewhat surprising in light of the most recent developments in theorizing - or rather speculating - about the major sources of international competitiveness in manufacturing. It says simply that for comparative advantage in the manufacturing sector at large the crucially important factor - from a brief list of basic resources - is physical capital. In other words, competitive strength in manufacturing as a whole lies with those countries that are abundantly endowed with physical capital. That such a statement empirically holds for physical capital rather than human capital comes as a surprise in view of much of the 'new' thinking about the major sources of international competitiveness.

This general result about the basis of international competitiveness in the manufacturing industries suggests at least one particular conclusion about the case of Turkey. From the empirical evidence on the structure of manufacturing output on the one hand and on resource endowments on the other it appears that Turkey's pattern of industrial specialization shows a larger weight in capital-intensive activities than seems to be warranted by the country's resource structure. In view of the proven significance of physical capital for industrial competitiveness this seems to be the 'right' type of specialization, if a continuous strenghtening of the manufacturing sector at large is the goal. However, at the same time the discrepancy between the country's resource structure on the one hand and the nature of specialization in production on the other suggests a certain degree of sub-optimality in the allocation of productive resources.

A second general empirical result on the sources of comparative advantage can be stated at the level of individual industries. While physical capital appears to be of overriding

importance for creating comparative advantage in manufacturing as a whole, there is little doubt about the fact that the actual pattern of industry-specific specialization is heavily influenced by other factors. If all manufacturing industries are viewed together, then it appears that so-called semi-skilled labour - that is neither workers that are unskilled nor those who possess skills and knowledge of the highest degree - is the major determinant of comparative advantage at the industry level.

More specifically it can be asserted that factor abundance does play a role also in the formation of the inter-industry pattern of international competitiveness within the manufacturing sector. And according to what the underlying theoretical model states this role is likely to increase with the broadening of possibilities for competition. In addition, it seems to be quite clear that only one of the basic factors of production, viz. semi-skilled labour, can be seen as the 'carrier' of the impact of factor abundance on competitiveness.

The fact that this particular resource accounts for most of the factor-abundance influence on trading patterns is not altogether counter-intuitive, for at least two reasons. First, the factor semi-skilled labour to a large extent fulfils the assumption of immobility between countries, a condition which is crucial to any factor-abundance reasoning. The movement of highly skilled labour between countries, as well as the migration of unskilled labour in great numbers in various parts of the world render the immobility assumption unrealistic for these two factors. Second, and maybe more importantly, semi-skilled labour represents a vital input in most industries due to the fact that it is composed of the broad category of workers whose skills are closely related to the production process. It is not hard to believe that a large reservoir of workers with production-oriented skills provides a solid basis for comparative advantage in specific industrial activities.

While the significance of conventional determinants of competitive strength comes as a surprise, there is little doubt that increasingly an alternative set of determining factors shapes the global patterns of specialization and trade in the manufacturing sector. And the influence on competitiveness of these factors is closely linked to forms of competition other than the one postulated in the perfectly competitive framework.

The conceivable alternatives to a world of perfect competition are many and accordingly a multitude of theoretical accounts can be thought of that would describe different forms of imperfect competition. Nevertheless, there are a number of traits that seem to be common to several versions of an imperfectly competitive world. One of these traits is technological, namely the occurrence of economies of scale in production. On the one hand scale economies usually change the nature of competition in that they call forth larger firms that are not merely price-takers. On the other hand, in an imperfectly competitive environment the potential to exploit scale economies becomes a crucial determinant of international competitiveness of a given country in an industry that exhibits increasing returns.

Another feature that is characteristic of the imperfectly competitive real world of international specialization and trade is the diversity of consumer prefences which leads to various forms of product differentiation. Such differentiation can be of a horizontal, vertical or technological type and constitutes a particular form of imperfect competition which is a 'natural' response of producers to diverse preferences. Like in the case of scale economies also in that of product differentiation not only the nature of competition and thus market structure are influenced, but also an industry's competitiveness. It depends to a large extent on firms' abilities to engage in product differentiation.

In the 'classic' case of a non-traditional form of competition economies of scale and product differentiation work together to produce a pattern of specialization that deviates substantially from what can be explained by conventional trade theories. Empirically such specialization manifests itself in the form of intra-industry trade by which is meant the concurrent export and import by a country of a narrowly defined category of products. Such trade cannot usually be explained on the basis of comparative-advantage arguments but demands to invoke a model of some form of imperfect competition. For this reason empirical measures of intra-industry trade can be interpreted indirectly as indicators for the extent of international specialization and trade that take place under conditions of imperfect competition.

An important empirical result on competitiveness under imperfect competition concerns the role of industrial concentration for the extent of intra-industry trade. Here it can be stated as a general finding that the less concentrated an industry is, the higher its share of intra-industry trade must be expected to rise. This result appears somewhat surprising at first glance for the reason that economies of scale are usually supposed to lie at the core of intra-industrial specialization. And to the extent that scale economies create entry barriers, the relationship between industrial concentration and intra-industry specialization would rather be expected to be positive than negative. The expected negative association, however, can be explained on the basis of the model of monopolistic competition. This model specifies a market structure of numerous suppliers and hence a low degree of industrial concentration. By means of (horizontal) product differentiation each one of these suppliers secures the possibility for exploiting scale economies. According to empirical evidence a good deal of intra-industrial specialization seems to be driven by competition of this sort rather than by competition between a few firms with great market power.

A second aspect concerns intra-industrial specialization between countries with significantly different profiles of factor endowments, in particular, specialization of this type between developing and developed countries. Here empirical results indicate that vertical product differentiation or differentiation in terms of quality plays a major part in intra-industry trade.

As was pointed out previously, the empirical results on international competitiveness reported above are relevant to several types of policies for competition or competitiveness. Regarding the important role of physical capital in determining comparative advantage in manufacturing the following points appear to be particularly relevant to the case of Turkey. The enhancement of competition, for example, by continuing liberalization of international trade is likely to lead to more export specialization of the same type, i.e., specialization in relatively labour-intensive industries. The reason for this is to be sought in the further strengthening of comparative-advantage forces which would basically reflect the current pattern of resource abundance. While an increase in this type of export specialization would lead to the usual static efficiency improvements, the long-run consequences of such developments have to be seen in light of the important role that physical capital plays in the realm of industrial competitiveness.

Here one feature in the picture of recent developments in Turkey's manufacturing industry seems to be particularly interesting. All reports on the country's export performance over the past decade highlight the unprecedented expansion of manufactured exports in which labour-intensive industries functioned as the motor, in particular as regards exports to the industrialized countries. At the same time it is stressed, however, that this impressive export performance has largely relied on existing capacity and has not led to any sizeable private investment in the industries concerned. Translated into the language of policies for competition and competitiveness this means that there is a great likelihood for such policies to

lead to substantially increased efficiency in the use of existing capacities while at the same time they may make little or no contribution to the longer-term goal of strengthening the industrial base, in particular its important physical-capital component.

Regarding the significance of semi-skilled labour as a determinant of the worldwide pattern of industrial specialization, there are also important implications for policy making in the areas of competition and competitiveness. If semi-skilled labour is of such crucial importance to industry-specific competitiveness, the above policies have to pay special attention to this factor. This applies mainly to two aspects, namely, the mobility across industries of this resource and also its overall endowment.

As regards mobility, both subsidy and restructuring policies ought to treat semi-skilled labour as a particularly important input that should be available in sufficient measure to those industries that evolve as the most competitive ones in international markets. To allow for sufficient inter-industry mobility of this labour category appears to be a formidable task, if one takes into account the often high specificity of its skill content and the consequently considerable barriers to its reallocation among different subsectors.

Finally, the empirical findings on determinants of intra-industrial competitiveness have implications for policy measures that are intended to foster competition. One probable consequence of introducing such measures is a reduction of industrial concentration in several subsectors. In contradiction to intuition and also to some theoretical reasoning such de-concentration does not in general diminish competitive strength in an intra-industrial sense but rather leads to more intense participation of industries in the 'new' forms of international specialization.

X. THE INTERNATIONAL SETTING

Patrick Low
The World Bank

For more than thirty years, Turkey has defined its external relations primarily in terms of its links with Western Europe, and the European Community (EC) in particular. This is reflected in the predominant shares of Turkish imports and exports accounted for by Western Europe (47 percent of imports and 59 percent of exports in 1990). Turkey has also been a member of GATT since 1951, and of the GATT-based Protocol Relating to Trade Negotiations Among Developing Countries since 1973. Other regional groupings to which Turkey belongs include a free trade agreement with the European Free Trade Association (EFTA), tariff preferences with Iran and Pakistan under the Economic cooperation Organization (ECO), and the fledgling accords under the Black Sea Economic Cooperation Zone (BSECZ).

This paper examines how important these arrangements have been, or might be in the future, in defining Turkish trade policy, including in the fields of antidumping and competition policy. The paper also considers the policy implications for Turkey of changing political and economic circumstances -- in particular, the broadening and deepening of European economic integration, the difficulties facing the multilateral trading system, and the growing policy emphasis on regionalism. The paper ends with a discussion of certain aspects of antidumping and competition policy.

Turkey's 1963 Association Agreement with the EC was predicated on the assumption that Turkey would eventually become a full member of the EC. Although the relationship ha[illegible]hrough many different phases, including extended periods [illegible]ivity, there

has been a gradual convergence of Turkish trade policies toward those of the EC. Turkey currently plans to establish an identical external tariff to that of the EC by the end of 1995, and eliminate most remaining trade barriers by that date, or shortly thereafter. At the same time, Turkey has adopted an antidumping statute and is in the process of implementing a competition law, both of which bear considerable resemblance to EC provisions in these areas. Similar arrangements as those with the EC are to apply in respect of trade with the member states of EFTA.

The objective of joining the EC may to some degree have acted as a spur to Turkey's economic and trade liberalization. But it is questionable how committed the EC has been to admitting Turkey to full membership, and this objective has been greatly complicated by the intensification of West European integration efforts. The EC has been a moving target for Turkey, particularly in recent years, in light of the Single European Act and the objective of monetary union under the Maastricht Treaty. Moreover, there has always been a question of how to integrate Turkey's large agricultural sector into the EC's common agricultural policy. If full EC membership is to remain elusive in the foreseeable future, then the question arises whether Turkey should "unilaterally" tie itself into an identical external policy regime to that of the EC without enjoying the full benefits of the customs union.

This paper argues that Turkey should maintain a diverse policy outlook that focuses first and foremost on its own priorities in a broad global context. In terms of its trade flows, some 20 percent of Turkey's imports and somewhat less of its exports are accounted for by countries with which Turkey maintains primarily GATT-based relations (including Canada, Japan, and the United States). In addition, significant new market opportunities potentially exist in the region, as a consequence of the fragmentation of the former Soviet Union. The scope for expanded trade and investment in these markets should be explored.

The extent of Turkey's participation in the GATT has been influenced by its relationship with the EC, and Turkey has not, therefore, played an active role at the multilateral level. The outcome of the Uruguay Round remains uncertain, but a successful completion of the negotiations would bring significant benefits in terms of trade liberalization and improved policy disciplines, especially in relation to tariff reductions and reform in textiles and agriculture. The benefits of the promised results are less certain in a few areas (including safeguards and intellectual property). Even if the Uruguay Round is not completed, Turkey would benefit from adherence to the Tokyo Round codes that it has not yet joined, including the antidumping, standards, import licensing and procurement codes.

Turkey has been intimately involved in the regional emphasis on trade relations, given its links with Western Europe. But as regionalism grows as a force in world trade, particularly after the abandonment by the United States of its exclusive reliance on multilateral trading arrangements, there is a danger that exclusionary trading blocs will reduce trading opportunities for countries that fall outside the blocs. Turkey could find itself facing such a danger, and should actively promote the development of non-exclusionary regional arrangements, whereby the primary criterion for participation is the capacity to meet clearly established policy standards, rather than a willingness to enter into market-sharing deals that divert trade and shut out third parties.

As Turkey has pursued trade liberalization, particularly over the last decade or so, it has joined the ranks of those countries that rely on an antidumping statute selectively to control import flows when domestic industries face competitive difficulties. The economic justification for antidumping is price predation, but predation is unlikely to occur frequently in international markets and is in any case very difficult to detect. The definition of

dumping as price discrimination between markets means that numerous commercial transactions by profit-maximizing firms operating in segmented and imperfect markets will be characterized as unfair trade and liable to sanction. From a political standpoint, however, antidumping may be seen by governments as a safety valve, necessary to maintain liberal trade policies in the face of protectionist pressures.

But there is a significant risk that antidumping can become a major instrument of protection, instead of a mechanism for keeping protectionist pressures at bay, and restrictive actions against imports within reasonable limits. The current GATT agreement gives little guidance as to best practice in this field, and the major industrial-country users of antidumping often provide object lessons in worst practice. Countries like Turkey would benefit from a carefully written and administered antidumping statute that avoids the protectionist excesses practiced by some countries, and prevents domestic monopolies from neutralizing the benefits of trade liberalization.

As Turkey plans for the adoption of a competition law, close attention should be paid to the degree of complexity sought in the law, bearing in mind the considerable administrative costs involved in properly applying competition law, and the risk of protectionist subversion of the provisions. An analysis should be undertaken of the extent to which trade policy can achieve the objectives of competition policy, particularly bearing in mind the potentially negative impact of antidumping actions on competitive conditions in the domestic market. There should also be an examination of the possibility that pre-existing policy interventions give rise to problems of a lack of competition in the market. In these cases, it may be more appropriate to focus on such interventions rather than on the elaboration of a new set of policies to offset the effects of existing ones. Finally, there should be no presumption that Turkey must mirror the EC approach to competition law.

XI. THE "NEW" TRADE THEORIES AND NEW TRADING OPPORTUNITIES FOR TURKEY

Raed Safadi
The World Bank

Critics of traditional trade theories had long claimed that these constructs neglected or severely played down such real-world phenomena as oligopoly, learning by doing, externalities, scale economies, domestic institutional constraints, and foreign ownership. Some trade economists reacted to these criticisms by turning their attention to issues of strategic policies and imperfect competition. They have borrowed extensively from recent developments in the literature on game theory and industrial organization, and have produced a much richer body of research, known collectively as the "new" theories of international trade. This new body of international trade theory not only modified conventional wisdom on free trade, but also supplemented the traditional analysis by emphasizing that increasing returns to scale, as much as comparative advantage, might be the engine that drives international trade.

Empirical investigations of the potential gain from mild protection in the presence of imperfect competition indicate that national welfare may actually rise, but only when assuming no retaliation. When retaliation is introduced, the cost of mutual protection is magnified by industrial organization effects. Furthermore, all these empirical models find that the gains that are supposed to ensure - when no retaliation is envisaged - are very small. In any case, the results of the empirical investigations of the "new" theories of trade are very much sensitive to the underlying assumptions, and as such are unreliable guides to policy. Finally, in the presence of discretionary authorities to intervene on purportedly strategic grounds, there is a risk that the decision-making process will be captured by protectionist interests.

As Turkey assesses the opportunities emerging from the dissolution of the Soviet Union, particularly in the new national markets within the region, a question that arises is what role, if any, the government might play in forcing closer links with these new entities. The "new" trade theories do not offer clear guidance on this issue, and if anything, suggest that a cautious approach should be adopted. On the other hand, there is evidence that government assistance made generally available to enterprises seeking to develop new external markets may be useful in the early stages. Such assistance should be designed with clear objectives in mind, and in such a way as to ensure that the subsidies are temporary and result in better export performance.

In an attempt to assess the magnitude of new market opportunities in the Former Soviet Union (FSU) area, I have adapted a gravity model of trade flows. The model provides a counter-factual indication of what Turkey's trade with the FSU would have been under "normal" market conditions.

Turkey's trade seems to be biased toward the European Community and against more natural partners like those in the Middle East region. This is consistent with other studies that find intra-regional trade in the Middle East to be very low. Thus, the predicted exports of Turkey to the Middle East are 6% higher that they actually are, and in imports, they are 9% higher. With respect to the European Community, Turkey's exports and imports are projected to be 6% and 4% lower, respectively, than they actually are.

Perhaps more importantly, the emergence of the FSU republics, especially where Turkey shares a common language or a common border, seem to create a large export potential for Turkey. This is evident from the 90% projected increase in its exports to these and other republics, and 75% projected increase in imports. It is important to note that these projections take into consideration only the actual economic performances of the FSU republics. In other words, the projections do not take into

account the potential growth of these republics, and hence are lower-bound limits on the potential exports of Turkey to these markets. Once the FSU countries return to their potential growth path, the growth "dividends" for Turkey may become even larger.

Policy Implications

The results summarized above which are the consequences of the dramatic changes that have occurred in the region argue for a more diversified approach. Turkey should seize the opportunities presented by the emerging markets and develop a coherent and diversified export strategy.

More than two-thirds of Turkey's exports is currently concentrated in manufactures where this trade has become increasingly globalized. Reductions in the cost of moving goods, and especially information, have encouraged the shipment of semi-manufactures between production sites. The production of labor-intensive goods is increasingly mobile, with low fixed costs, easily separable production steps. Mcreover, as is evident from the previous section, distances between nations also influence patterns of trade strongly, particularly in the case of manufactures, because they impose transaction costs on production and trade. Studies suggest that if distance doubles, than trade between countries of equal size declines by two-thirds. A common land border between countries increases trade by a factor close to two. A common language also leads to more trade, as do past political and commercial ties.

The economic distance between nations - influenced by geographical location, culture, and history - is an important factor in assessing the export prospects. This distance can be reduced by better infrastructure, transport and telecommunications, and by more open policies for trade in goods and services, foreign direct investment, and movement of people. Such links permit close interaction with buyers and suppliers in the quest for international competitiveness, and help translate

low labor costs into low production costs.

Recent trends in technology have made these international linkages even more important for international competitiveness. New technologies permit more differentiated products, and sale of a wider range of products requires more detailed market intelligence. "Just-in-time" inventory management techniques, and the trend toward design from manufacture require close coordination between producers and suppliers, designers and component manufacturers. The growing interaction between markets, consumers, producers, and suppliers requires more efficient communications.

Increasingly, the "new" trade theories are explicitly recognizing the important role that marketing and informational flows play in international trade. This arises from imperfect competition, since in a neoclassical framework, sales and information flows are costless and instantaneous. Moreover, the "new" trade theories are beginning to recognize other leading problems of exporting manufactures from developing countries, such as obtaining access to competitively priced inputs, services, and infrastructure.

Recognizing the importance of these issues, the World Bank initiated research to formulate cost-effective public support in developing countries for export marketing, particularly programs in manufactured goods. Preliminary findings suggest that one particular policy instrument appears to be promising in this respect. A fund providing grants sharing up to half of the costs of well-designed programs of export marketing by firms themselves, involving new products, markets or quantum changes in the way exports are marketed in demanding markets. Such a fund is provided, for example, by Singapore's Trade Development Board, and others have been included in World Bank operations in Indonesia. This allows firms to choose what they want advise on, and also to choose service suppliers, not least from the private sector.

XII. WHAT ARE THE POLICY PRIORITIES?

Refik Erzan
Bogazici University / The World Bank

If I had to rank order policy areas according to their importance in shaping the competition environment, the first place would go to macroeconomic policies, ironically an area outside the scope of this study. Nevertheless, I must underline that, in the absence of macroeconomic stability, with small fiscal deficits and low inflation, our specific competition policy proposals would have limited impact at best. Large deficits and high public borrowing "crowd out" investment and give an advantage to existing firms, especially the dominant ones. Inflation distorts the informational value of prices in signaling relative scarcities, as well as opportunities and risks.

The papers presented do not deal with privatization per se. However in almost all aspects of competition policy we deal with, the dominant role of state economic enterprises comes up as a hinder, and privatization is discussed. This is inevitable since without challenging the monopoly power or the dominant market share of the overwhelming "holding company" in the economy, namely the State, it would be quite difficult to promote competition.

Privatization also enters the equation in terms of resources for some of the proposed measures: trade liberalization reduces government revenues, investment in physical infrastructure and human skills have to be financed, restructuring of firms requires funds, etc. Hence privatization would both enable policies to promote competition through improving the macro resource balance as well as contribute to it at the micro level.

"Incentive Schemes"

Investment and export encouragement schemes date back to 1960s and their complexity have increased many folds since. During the import substitution era until 1980, the import regime and foreign exchange allocation were the main instruments for promoting industry, while outright export subsidies under the guise of "tax rebates" and foreign exchange retention schemes were used to make exports profitable.

As the quotas and licensing were dismantled, and foreign exchange restrictions removed, the government lost its most potent instrument of industrial policy. Furthermore, as the quota and licensing schemes loaded the burden of subsidizing the industry directly on consumers, their elimination meant higher tariff and tax exemptions and cash payments from the treasury to attain the same level of support. Given fiscal constraints, this would have been only possible in a selective way. Instead, the government issued investment certificates to nearly all kinds of investment. Hence, by design and default, there was no more an industrial strategy. The main effect of this has been reducing the effective tax rate of the larger companies, which could exploit all "incentive schemes", to about 10-15 percent.

This effect in itself was not necessarily bad for the economy. Almost all countries which go through trade and financial liberalization increase the efficiency in using installed capacity, but fixed capital formation slows down radically. Some economists argue that financial liberalization should be delayed to keep the cost of capital relatively low during the structural adjustment in the industrial base.

What was wrong in the policy was that, there was no need to have a complex investment incentive scheme which promoted rent-seeking and which had a strong bias in favor of large corporations. The government could simply reduce the tax rate. Obviously there would be no room in the budget for a reduction

of the corporate tax from 46 to 10-15 percent for all, but probably to 20-25 percent.

We have not explicitly studied the current Law on reforming the corporate tax structure. However I support the general principle of having a unitary and relatively low corporate tax with minimum deductibles, affecting small and large corporations alike.

If the Law becomes effective - hopefully not retroactively - it will nullify many current tax breaks. This is a good opportunity to scrap the investment and export encouragement schemes altogether, and start from scratch.

Industrial Policy

I do not think Turkey can have "an institutional setting characterized by a 'hard' State and strong government discipline over the private sector", a premise behind the success of the East Asian industrial strategies, as Rodrik puts it. Besides, I do not think I would like to live in such a State.

Outward orientation has been achieved. A strategy is lacking. We argue that they are not incompatible.

As proponents of privatization and as champions of a market based, outward oriented strategy, we do not call for rolling back and weakening the State proper. All the proposals we list would be served best by a more efficient State with clearer objectives, and greater capacity and focus. That requires, among other things, a viable State budget.

In addition to macroeconomic stability with small fiscal deficits and low inflation, the building of physical infrastructure and investment in health and human skills is the most powerful form of industrial policy.

Concerning human skills, Forstner's observation that semi-skilled labor is an extremely important factor of production in industry, has clear policy implications. We have to stop opening new universities that lack staff and facilities. Instead, the government should promote technical education and seek the participation of the private sector in this endeavor. As Forstner points out, it is not only the stock of this semi-skilled labor, but its intersectoral mobility that matters a lot. To facilate that, a comprehensive unemployment compensation scheme has to be enacted with a strong emphasis on retraining.

There are three, what I consider, special areas where the government should focus. The first is the promotion of small and medium size enterprises (SMSEs) and new entrants. The second is priority development regions, and the third is a regional strategy for Turkey geared to the new markets and opportunities in our neighborhood.

Besides their extremely important role in providing employment, SMSEs and new entrants are indispensable for the dynamics of competition. However, they suffer more from high inflation, high interest rates and, generally, from macroeconomic instability. On the other hand, they would benefit more from general support to infrastructure, health and education. More is needed though. Specific measures can be warranted to improve the access of SMSEs to factor (capital, skilled labor and technology) and product markets, both domestic and international. I laid down some proposals: (i) changes in Eximbank rules, (ii) short and long term loan guarantee schemes, (iii) promotion of venture capital, (iv) an information campaign, probably spearheaded by KOSGEB, and (v) supporting SMSEs' collaboration with universities and technical schools.

SMSEs are not all angels of competition, however. Many are worse polluters than large scale firms (in proportion to their output), tax evasion is widespread, labor without social security cover is employed, safety and security standards are usually

ignored. The specific measures should be designed with the double purpose of giving the SMSEs a boost while bringing them under the umbrella of general standards. As many SMSEs would partly lose their cost advantage in this process, during a transitionary period, cash incentives and tax benefits might be provided. Such incentives can be tied to voluntary inspection schemes. Improved accounting practices can be rewarded by tax credits while investment upgrading working conditions and environmental standards can be supported by subsidies.

For **priority development regions**, the success rate of the GAP experiment will be decisive.

I think it will work, and I see a project based approach superior to general investment promotion.

In restructuring policies, we have a separate proposal for these special regions.

I save the regional strategy to the last.

Foreign Trade Regime

Currently the customs tariffs proper constitute only a fraction of the actual charges levied on imports. There are numerous surcharges, including a levy for the Mass Housing Fund (henceforth the Fund). If the customs tariff in the book is zero, the other charges add up to 26 percent. It is not that straightforward either. There is a saying in business community that to know the exact amount of levies on a certain product, you actually have to import it.

The government has been making preparations in the last year or two to consolidate the import surcharges and come up with a unified tariff schedule. Presumably there will be one rate for the EC, one for others, and one single surcharge , the Fund. Parallel to this, the government is making preparations to

implement the envisaged customs union with the EC by 1995, meaning eliminating tariffs applied to the EC in yearly steps, and adopting EC's Common External Tariff. The fund levy will continue until 1998.

Sounds nice and easy. It is not. Nobody in his right mind is against the unified tariff structure. However no one knows what it will entail. What will be the level and structure of the tariffs and the Fund? Is the government serious in joining EC's customs union by, 1995? What will be the schedule of tariff and Fund cuts for each year?

By the end of 1992, the government has to come up with the import regime for 1993. However that will only give hints on the future course of the trade regime. Everything in principle is reversible.

Concerning the customs union with the EC, the opinions are split in the country, and this cuts across the business community, the administration, political parties and the academics. The dominant argument against the union is that we should keep it as our trump card and play it only in return for a tangible schedule in joining the EC.

I think there is an overwhelming case to declare unilaterally that we will join the customs union by 1995.

What I consider the compelling reason for this committement is quite different from most arguments used in the Turkish debate, and whether Turkey ultimately joins the EC or not is immaterial from this point of view. The stability and predictability of the system is the most important singe characteristic of any successful policy. The trade regime has been subject to political and business pressures over the decades, and its volatility continues to this date. I see the customs union with the EC the only guarantee to take this instrument out of the policy domain. The "strait jacket" would

be a relief to the politicians.

On pure economic grounds, the damage of high protection on national welfare is well documented. However, the difference between zero protection and a 10-15 percent relatively uniform tariff is not that great, one way or the other.

To reap the maximum benefits of stability and predictability of the trade regime, the government should announce a transparent schedule for the tariff and Fund reductions, and <u>seal</u> it with the EC.

The findings of Katircioglu and Engin show that imports do work "as-market discipline". What we had in the 1980s was not too much liberalization in trade, but probably too little of it.

Competition in the Banking Sector

Thanks to financial liberalization in the 1980s, and relaxation of entry requirements, a large number of new banks, both domestic and foreign, entered the market. This has improved the quality of financial services, product variety and the technology of the sector in general as well as contributing to the globalization of the Turkish banking system. However, almost none of the new banks entered the retail banking market. The established banks with vast branch networks developed during the non-price competition era before financial liberalization have a predominant hold over the retail market.

Denizer's study shows that market structure, that is concentration, is the primary determinant of Bank profitability in Turkey. Furthermore, concentration of the market profits both the large and smaller banks. The study also finds that effective competition in the banking sector requires that the entrants have a certain size. New banks filled certain niches in the market with specialized services, but their impact on competition at retail banking without a sizable branch network has been limited.

In a number of occasions, public banks have been directed to raise their deposit rates when large private sector banks set their rates below the smaller banks, and sometimes even below the inflation rate. this is obviously not a long term solution and certainly incompatible with financial liberalization.

Promoting competition in this market requires facilitating rivalry among the top 10 or so banks. This in turn necessitates entry of new banks with a reasonable number of branches, that is entry at a certain size. To achieve this in the short term, we propose (i) the breaking up and privatization of the public banks, probably excluding the agriculture bank and three development banks. Through this, 15 to 20 new banks, each with a sufficient branch network, can be created, reducing concentration and increasing competition in the retail market. (ii) Promoting building societies and local banks is the other step to increase competition. Although their sizes would be small, unlike the merchant banks , they would effectively compete for deposits. These would also help establishing a mortgage market, badly needed in Turkey. To achieve this, capital requirements should be lowered. (iii) At the same time, the supervisory and regulatory capacity and authority of the Central Bank should be expanded - a lesson we should learn from the banking crises in Turkey and around the World in the 1980s.

Restructuring and Exit Policies

Rescuing a company in distress cannot be an objective in itself. A nonviable firm sits on resources which can be efficiently used in some other activity. Furthermore, the possibility of exit is as important as new entry to maintain and promote competition. The guiding principles of the government in this area should be the maximization of the value of productive assets, and the internalization of the costs of mismanagement (and eventual restructuring) by the owners of those assets. For State economic enterprises, I see privatization as the only way to fully adhere to these principles since government property and

government money are abstract concepts, detached from the tax payers, and citizens in general, who own them.

For efficient restructuring (or liquidation) in the private sector, we have a number of specific policy proposals:

(i) The government should immediately stop random bailouts. In exceptional cases where the existence of a major operation is in immediate jeopardy, where seezing the activity even temporarily would significantly damage the assets of the firm, government development banks can provide bridging finance by mortgaging the assets of the firm.

(ii) Promote market agents that specialize in company workouts. Those agents' rewards should be strictly tied to the performance of the firms following the restructuring. This can be best secured by their equity participation. To promote these company workouts, the government can and should subsidize part of the costs of the feasibility study to determine the viability of the firm and the specifics of restructuring.

(iii) The government should review and modify the Company Rescue Law of 1987, which has so far been totally ineffective. The paper by Atiyas provides insights concerning the shortcomings of this law.

(iv) The government should immediately form a commission to study the Bankruptcy Law (Icra Iflas Kanunu), particularly the concordat process, to reform the legal framework along the lines of Chapter 11 in the US legislation.

(v) Distressed firms in priority development regions deserve special attention. However the restructuring problem in these firms should be de-coupled from the regional and employment objectives. The value of an additional job in the region and the acceptable level of subsidy to maintain it should be established independent of the cost of restructuring. Then, given these figures, the viability of the enterprises should be examined. Those which prove viable should get direct subsidies. The ones which prove unviable even after factoring in the subsidies should be closed down.

In restructuring firms in the priority development regions,

like in other regions, market agents should be promoted. In these areas the rate of subsidy for feasibility studies could be set higher.

(vi) Lastly, but most importantly, an <u>unemployment compensation scheme</u> should be enacted urgently. This is a crucial ingredient of any major restructuring drive, be it in the private or the public sector. In this scheme, rewards to retraining and labor mobility should be the cornerstones. The plan should also take into consideration regional differences and priorities, both in the amount and duration of the compensation.

Competition Law

The argument in favor of competition law, based on economic rationale and international experience, is convincing. However, to draft such a law which should (i) have the objective to maintain and promote competition to improve economic efficiency without hampering international competitiveness, and (ii) to devise the machinery which would implement it effectively and without abuse are very serious matters. (iii) The Law should also be promoting broad and systematic incorporation of competition principles in government policymaking. (iv) Most importantly, such a legal framework is meant to set a standard of business morality -compatible with international practices.

The specific shortcomings of the current Draft Law -both in substance and organization- are well discussed by Dutz. There is also a fundamental problem. While this legislation has such a far reaching potential socioeconomic impact, I have doubts that it is seriously discussed among the members of the government, let alone any major effort in involving the business community and the general public. Not having gone through a proper scrutiny, the current Draft Law draws a framework which is open to political pressure and other abuse.

The Draft Law has indeed achieved an objective by bringing the subject to the national agenda. Now it is time to make a

fresh start: (i) A special commission should be set-up with the backing of the whole government to make a detailed study of the market structure and conduct, entry barriers, and the perils and merits of different forms of competition legislation, including alternative organizational setups. Some of the papers presented in this conference is a starting point. (ii) Following the publication of the reports, there should be an extensive debate, as Italy has recently gone through. (iii) The input of the business community should be sought at an early stage. (iv) In building a broad consensus in support of the competition law, this preparatory phase should be highly transparent and well publicized to serve an important educational function for business and public at large.

Antidumping

The 1989 "Legislation on the Prevention of Unfair Competition in Importation" has the same shortcomings as other GATT-consistent antidumping and antisubsidy laws. It carries with it the danger of being used as any other protectionist device. In Turkey, so far its main target was imports from poorer countries. If trade liberalization and customs union with the EC proceeds as planned, the pressure will increase considerably for a wider use of this legislation, diluting the benefits of liberalization. It can become a tool for collusion between domestic and foreign, particularly EC, firms.

The Uruguay Round negotiations on antidumping do not seem to yield an international agreement imposing better disciplines. Consequently, the only way is unilateral improvements in antidumping rules.

In Turkey, the Board which is in charge of the implementation of the Law is not an autonomous body. It is potentially subject to political and other pressures. At this point, it is probably not realistic to suggest major changes in the substance and organization of the Law. Short of that, the

government can issue a Decree or a Directive containing the following amendments or guidelines: (i) In determining "material injury", import surges have been used by far as the dominant factor. The Board should refrain basing its decisions predominantly on import surges, and should examine other factors. (ii) The Board should do its best in getting at actual prices for comparisons, rather than using dubious constructed values. To this end, the resources of the Board should be augmented. (iii) The Board should explicitly consider the benefit to consumers and to industrial users of the cheaper imports while investigating the alleged adverse effects on the producers.

A Regional Strategy toward New Markets

While I argued against an industrial policy selective in terms of sectors, I strongly defend a strategy geared to new markets.

The Former Soviet Union (FSU), and particularly the Turkic Republics offer important opportunities. Safadi's analysis finds that Turkey's trade with these countries would be double what it is now. That is a gross underestimation for the prospects since we expect the incomes in these countries to pick up quite rapidly.

New markets mean that communications, transportation, banking channels and all other infrastructure for trade and investment have to be strengthened. There are market imperfections requiring major outlays.

I do not rule out subsidized export credits, but it is an indirect and expensive way of dealing with the actual problem. The question is finding cost-effective means of public support to export marketing. In fact, there is ongoing research in the World Bank on this subject. A government fund providing grants up to half of the cost of well-designed programs of export marketing firms is working well in a couple of countries.

We already have DEIK (The Council of Foreign Economic Relations) serving the business community with minimal bureaucracy. We must look into ways of strengthening it.

Promoting non-exclusionary and market based regional arrangements is not in conflict with the aspiration of joining the EC. On the contrary, the recent improvements in the EC relations did not come about as a result of our diplomacy in Brussels. It seems that the message goes faster to Brussels via our increasing ties with Moscow, Baku, Alma Ata and so on.

* * *

I would like to conclude with a less than totally altruistic note. Efficient policy formulation and implementation ultimately means well motivated individuals with strong analytical and administrative capacities and international exposure. Where will the government draw this talent from when the quality of higher education and research has been traded in for quantity of university students?