BUSINESS DAY

A Crucible in Turkey

By MARK LANDLER AUG. 5, 2005

EREGLI, Turkey - A fierce-looking banner strung between two trees in this hillside town on the Black Sea sums up how the locals here feel about the steel factory that is their principal employer: "Erdemir is our sweat," it proclaims. "Each of us would die for it."

Turkey recently put this state-controlled company, its biggest steel maker, on the auction block.

With 13 suitors lining up to bid, including firms from Russia, Britain and South Korea, Erdemir could become one of Turkey's most successful privatizations -- a potent symbol of its economic progress as Turkey begins arduous negotiations this fall to join the European Union.

But first the sale has to happen.

The auction process has run into an unexpected surge of opposition from political leaders and business executives, who argue that privatizing the company is not necessary, given its profits.

Moreover, they add, Turkey cannot afford to surrender a strategic asset, especially when Europeans seem increasingly reluctant to admit the Turks into their club of nations.

Then there are the factory's 7,500 workers, who fear they could lose their jobs under a foreign owner. Protests have erupted here and in other cities, as Erdemir has become a fraught symbol of Turkey's uneasy passage from its sheltered past into a free-market future.

"This is a real test for Turkey," said Metin Kilci, the president of the Turkish Privatization Administration, which hopes to sell Erdemir by the end of the year and follow it with sales of other state assets, including an insurance company, a sugar factory and the Istanbul Hilton.

The Turkish government has won kudos for stabilizing the economy, with the help of loans from the International Monetary Fund, after a deep crisis in 2001 brought this nation of 69 million to the brink of bankruptcy. Turkey's output grew nearly 9 percent last year, a pace that rivaled that of China.

The government of Prime Minister Recep Tayyip Erdogan is also credited with taming decades of sky-high inflation, which had turned Turkey's currency, the lira, into something close to funny money.

But the process of privatizing state-owned companies has been dogged for 20 years by legal challenges and political interference. As Turkey bids for a place in the European Union -- a step the United States supports -- it is eager to show its resolve to open its economy.

"We would be more than happy if a foreign company wins this tender," Mr. Kilci said in an interview in Ankara, the nation's capital.

Mr. Kilci expressed disappointment that the United States Steel Corporation was not on the initial list of potential bidders, and said he hoped it might join in later. U.S. Steel, based in Pittsburgh, owns factories in Slovakia and Serbia. A spokeswoman for the company declined to comment.

Analysts, however, said a sale to any foreign buyer could still be blocked. The chamber of commerce here has filed a suit opposing a sale. National opposition is robust and well organized. And there is a receptive audience for dark warnings about foreigners taking advantage of Turks. The dispute has been featured on the front pages for weeks.

"There's a Turkish saying, 'We serve foreigners the best meat -- the lamb without the bones,'" said Cemal Senturk, who represents local manufacturers that buy steel plates from Erdemir.

Turkey's attitude toward outsiders has not been softened by the chilly reception it is getting these days in Europe. Although its campaign to join the union is still officially on track, with membership negotiations scheduled to start in early October, popular sentiment in Europe has turned noticeably against it.

Some of that is fueled by fears that low-cost Turkish workers will take European jobs. Some is linked to security concerns that have intensified since the London bombings: as a Muslim country, Turkey cannot escape the taint of radical Islamic militancy, even if it is a moderate secular society.

Politics reflects the popular mood. In Germany, Angela Merkel, a conservative leader who opposes Turkey's bid, is leading in polls six weeks before an election for chancellor. In France, the politician of the moment is Nicolas Sarkozy, the interior minister and would-be president, who has also expressed qualms about Turkey.

"The Turks are quite angry," said Katinka Barysch, the chief economist of the Center for European Reform, a research group in London, who recently wrote a report about Turkey. "They think, 'We've done so much for the E.U., now the E.U. needs to do something for us.'"

In the case of Erdemir and its steel operation, critics say Europe's biggest contribution would be to skim off the cream of its output.

The company currently supplies about one-third of Turkey's demand for flat steel, which is used to make ships, cars, machinery and household appliances. If a foreign buyer took over Erdemir, people here say the company would export the high-quality steel to Western Europe, forcing Turkish companies to switch to lower-quality steel imported from Ukraine or Kazakhstan.

"The foreigners are very profit-oriented," Mr. Senturk said. "Why would they care about the problems in Turkey?"

Twenty-three Turkish manufacturers that buy steel from Erdemir have banded together to submit their own bid for the company. But they face well-financed rivals, like Mittal Steel of London and Arcelor, based in Luxembourg, which are the world's two largest steel makers.

Owning a steel plant in Turkey is attractive, analysts say, because the country has become a hub for auto manufacturing: Ford, Toyota, Renault and Fiat make cars here. Arcelor has ties to Renault, analysts say, and might like a Turkish factory to supply the local Renault plant.

More broadly, the global steel industry is ripe for consolidation. After two years of voracious demand, much of it driven by China's economy, analysts predict a sharp slowdown in sales, which could result in a surplus. Acquisitive giants like Mittal, which already owns 8.6 percent of Erdemir's shares, are seizing the chance to add to their holdings.

The Turkish government knows it has a brief window in which it can command a premium price. "Steel is a cyclical business," Mr. Kilci said. "In five years, it might be losing money again."

Erdemir was founded in 1960 and began production in 1965. It lost a total of $169 million from 2001 to 2002, which were difficult years for the steel industry, before rebounding with a profit of $261 million in 2003 and $473 million last year.

Although the Turkish state owns only 46 percent of Erdemir's shares, it controls the board and appoints senior management. Even those managers sounded dubious when asked why Turkey should sell it.

"That's the question I constantly keep asking," said A. Kerim Dervisoglu, who became the chief executive in 2003.

Mr. Dervisoglu trimmed the work force to 7,500 people, from 8,400. He upgraded the factory's two hot-rolling mills, which expanded their production capacity. And he began construction of a cavernous new mill, which will turn out large plates of steel suitable for shipbuilding.

On Tuesday, days after this interview, Erdemir announced that Mr. Dervisoglu had stepped down as chief executive because of poor health. Analysts in Istanbul said his exit most likely reflected his feelings about the sale.

The pressure to divest Erdemir is also driven by Turkey's parlous public finances. The Turkish government is running a budget deficit equivalent to 8 percent of its gross domestic product. The company, which is publicly traded, has a market capitalization of $2.5 billion. Given a premium for change of control, that implies Ankara could realize $1.5 billion for its stake.

Beyond that, privatizations are a handy way to attract foreign investors. Turkey lured only $1.2 billion in foreign direct investment last year, a paltry number for an economy of its size. Foreigners have been put off by the cumbersome regulations and, until recently, the gyrating economy.

While Erdemir is making money, some critics say its financial prowess has been wildly exaggerated.

"It's making a profit because the demand for steel is going crazy in places like China," said Ishak Alaton, the chairman of Alarko Holding, a conglomerate with interests in construction, fisheries and resort hotels. "If it were in private hands, it would make 10 times the profit."

Mr. Alaton said a cabal of government bureaucrats and business people was fomenting opposition to the sale of Erdemir out of a desire to maintain control of a lucrative asset.

The opportunities for corruption are easy to see. Mr. Kilci noted that Erdemir had always supplied the president of the privatization administration with a free car -- in his case, an Audi A6. "After we privatize Erdemir, I'll have to switch to a Fiat," he said with a wry laugh.

Critics, however, say the government's headlong rush to sell a thriving company could weaken public support for future sales. "It gives the impression of being ideological rather than rational or economic," said Gunhan Karakullukcu, an economist and business consultant.

Here in Erdemir's hometown, the feelings are mostly personal. The company has built schools, movie theaters and sports centers for Eregli, and donated property for employees to build houses. It even sponsors an annual "love, peace and friendship" festival.

"This is not only financial," said Semsi Durdu, a Hyundai dealer who depends on the factory's workers for a good portion of his sales. "There's a lot of emotion attached to it."