

Investment or Corruption? The Story of Zafer Airport

Cenap Ilter*

This article presents a corruption story from Turkey. It's about a Build Operate Transfer project: building and operating an airport in the mid-western territory by a private company. The salient feature of the project is that the Turkish Government granted the project to a company without competitive bidding. Assigning a job without bidding is a sign of corruption, and, what is even more important, the Government guaranteed the number of passengers flying from the airport for purposes of the passenger facility charges (the airport fee, which is part of the ticket price). Neither the author nor the public has access to the contract for the project. The information obtained comes from the internet through the declarations of the opposition party's members of the parliament. All calculations have been made based on the information obtained through the internet. In this case the contractor's business risk is zero. The number of people who actually flew in the first eight years and seven months of the project was only 3.3 percent of the scheduled number of passengers on the contract.

Introduction

This is the story of Zafer (which means victory in Turkish) Airport (Zafer). This airport was opened in November 2012 after 18 months of construction to serve the regional demand of passengers for Kutahya (distance to the airport is 45.3 km), Afyonkarahisar (distance to the airport is 60.4 km), and Usak (distance to the airport is 119 km), three nearby cities in the western part of Turkey. The populations of these cities are (based on 2020 data): Kutahya, 576,688; Afyonkarahisar, 736,912; and Usak, 369,433. The total population is 1,683,033.

Zafer was built and operated by a private contractor on the BOT (Build, Operate, Transfer) model. BOT is a system under which governments ask private sector companies to undertake a project for a public good, to complete the project, and to operate it for a certain period to recover its cost and

* Cenap Ilter is a Professor of Accounting at California State University Dominguez Hills. He can be reached at cilter@csudh.edu.

make a profit, while the government bears the business risks. The operating period, cost of the project, and how much revenue the private company will make must be calculated in advance, with the numbers known to all parties (the government, the contractor, and the public).

In the case of Zafer, the operating period is 29 years and 11 months. Zafer started to operate on November 24, 2012, and the BOT company will turn it back on March 21, 2044. According to the BOT agreement, the Turkish Government (the Government) guarantees a passenger facility charge of €2 per domestic and €10 per international departing passenger, paying the difference between the actual number of passengers flown and the minimum guaranteed number of passengers on the contract. The guaranteed number of passengers progressively increases (on a “fly from” basis) per year until the end of the tenth year. From then on, the number of guaranteed passengers doesn’t change, but the payment guarantee continues until the end of the contract. That is, if the number of real passengers using the airport does not equal or exceed the number of passengers guaranteed for any particular year, the difference is paid to the contractor by the Government.

The cost of the airport is €50 million.¹ Under normal economic conditions, a BOT project is an undertaking by a private sector company with the attendant risks and returns. In the case of Zafer, the risk is undertaken by the Government, and that is the subject of this article. The names of the contractor company and the Government officers and politicians who made the decisions will not be spelled out; the public in Turkey knows about them. The objective of this article is to inform the academic and the larger investment world that corruption can go to such extremes that no calculation of the payback amount can justify it.

In this case, the expected payback amount is approximately €263 million. (This calculation is an estimated one from the internet resources. To be exact it is €262,937,937.) It is an amount that is more than five times (526 percent) the initial investment (€50 million), which is unprecedented in Turkish economic history. The signed contract is not publicly accessible, and the information for this article has been obtained from the internet, either in the form of YouTube news channels or opposition-party views and explanations published on the internet. In the lines below only the cash flows have been analyzed as revenue from departing passengers. The contractor might have other revenue from the tax-free shops’ rents in the airport, push back, fueling, cleaning, de-icing services to the planes, and so on. Also, the contractor has expenses, including for personnel, electricity, water, gas, and depreciation. The contractor might have been given tax incentives. Neither any tax

¹ See <https://www.parlamentohaber.com/maliyeti-50-milyon-euro-olan-zafer-havalimanina-208-milyon-euro-odenecek/>.

incentives nor any tax burdens have been taken into account since all these revenues and expenses are not publicly accessible information.

Literature Review

Government corruption is a widespread phenomenon worldwide and, although it certainly occurs in developed countries, it is most pervasive in developing countries. Especially in developing countries, public spending on programs for the poor is often mistargeted and creates pockets of corruption and favoritism; and often certain lobbies come out as big winners at the expense of the truly needy.² Many policymakers and observers appear to be aware of this trade-off. Examples in the literature involving both developed and developing countries include China,³ South Africa,⁴ Italy,⁵ Russia,⁶ Indonesia,⁷ Kazakhstan,⁸ the United States,⁹ Tanzania,¹⁰ and New South Wales.¹¹

² Alberto Alesina & George-Marios Angeletos, "Corruption, Inequality, and Fairness," 52 *J. Monetary Econ.* 1227, 1241 (2005).

³ See Li Tian, Jing Yu Yang & Jiatao Li, "Does Legal Registration Help or Hurt? The Effect of Government Corruption on Resource Acquisition by Nascent Ventures in an Emerging Economy," 38 *Asia Pacific J. Mgmt.* 547 (2021) (analyzing 160 nascent entrepreneurs in China between 2009 and 2011).

⁴ See Sandra Sequeira & Simeon Djankov, "Corruption and Firm Behavior: Evidence From African Ports," 94 *J. Int'l Econ.* 277, 277–78 (2014) (examining the impact of corruption on firms' choices of ports).

⁵ See Alberto Vannucci, "The Controversial Legacy of 'Mani Pulite': A Critical Analysis of Italian Corruption and Anti-Corruption Policies," 1 *Bull. Italian Pol.* 233, 242 (2009) (concluding that in the prior decade corruption in Italy had become more widespread, less risky, and less likely to attract media attention).

⁶ See Alexander Pavroz, "Corruption-Oriented Model of Governance in Contemporary Russia," 50(2) *Communist & Post-Communist Stud.* 145, 146 (2017) (noting that, after the fall of the Soviet Union, politicians and public officials had nearly unlimited ability to use their offices for their own benefit).

⁷ See Blane D. Lewis & Adrianus Hendrawan, "The Impact of Majority Coalitions on Local Government Spending, Service Delivery, and Corruption in Indonesia," 58 *Eur. J. Pol. Econ.* 178 (2019) (hypothesizing that budget fraud serves to finance local parliamentary and executive elections).

⁸ See Ainur Mahmutovna Kassenova, "Problems of the Legal Regulation and Practice of Enforcing Additional Punishment for Corruption-Related Offenses in Kazakhstan," 10(1) *J. Advanced Res. in L. & Econ.* 227 (Mar. 2019) (concluding that corruption has become widespread in in Kazakhstan society and government bodies).

⁹ See Jared D. Smith, "US Political Corruption and Firm Financial Policies," 121 *J. Fin. Econ.* 350 (2016) (finding that firms in more corrupt areas have less cash but greater leverage than firms in less corrupt areas).

¹⁰ See Lucy Koehlin, *Corruption as an Empty Signifier; Politics and Political Order in Africa* 145–46 (2013) (discussing the Warioba Report, which provided detailed description of corrupt practices in public agencies).

¹¹ See Rodney Tiffen, *Scandals: Media, Politics & Corruption in Contemporary Australia* 7 (1999) (discussing alleged corruption to protect pedophiles in high positions).

Cash Flow Projections Versus Reality

The BOT agreement referred to in the introduction is based on passengers departing from the airport. Table 1 shows the first 10 years of operational numbers. Year 10 numbers have been extended to the end of the project (the remaining 19 years and 11 months) but are not shown in the table.

The contractor spent €50 million to build the airport within 18 months. From the opening date (November 25, 2012) until maturity (March 21, 2044), the contractor expects to make annually an average of €8,789,012. Table 2 shows this calculation:

The annual cash flows shown in Table 2 produce a present value (PV) discount rate of 18.11 percent, an internal rate of return (IRR) of 17.43 percent, and a return on investment (ROI) rate of 17.58 percent (not all calculations are shown here).

Between November 2012 and June 2021 (eight years and seven months—or a total of 103 months), the number of guaranteed passengers was 9,903,710, and the actual number of passengers who flew from Zafer was 326,322 (an average of 38,018 passengers per year), the deviation rate being 96.7 percent. The airport's total passenger capacity is two million/year. Total payment made to the contractor within the 103-month period was €51,093,308. According to the agreement the government guarantees €2 per passenger for domestic flights and €10 per passenger

Table 1: Number of Passengers Guaranteed by the Government

Years	1	2	3	4	5	6	7	8	9	10
Domestic	500,000	535,000	569,775	603,962	637,179	669,038	699,145	727,111	752,560	775,137
International	350,000	374,500	398,843	422,773	446,028	469,327	489,402	508,978	526,792	542,596
Total	850,000	909,500	968,618	1,026,735	1,083,207	1,138,365	1,188,547	1,236,089	1,279,352	1,317,733
Annual increase %		7.0	6.5	6.0	5.5	5.1	4.4	4.0	3.5	3.0
Int. pass. Rate	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2

Table 2: Contractor's Expected Annual Returns for Duration of Contract (All Calculations in Euros)

Average annual payment	8,789,012
Period (years)	29.92
Total payments	262,937,937
Present value of payments	(50,000,000.00)
Discount rate	18.11%

for international flights.¹² The numbers show that the contractor in nominal terms recovered its investment in less than nine years.

Long-Term Cost to Government

This section shows the situation as of June 2021 (eight years and seven months after the start of operations) and takes it to the end of the project. Here, we look at the situation from the Government's point of view. According to the numbers given previously in Table 1, the average payment to the contractor per year was €5,952,618 based on a 96.7 percent deviation rate. Since we do not have the contract between the contractor and the Government, we can only assume that this deviation rate continues (despite the fact that it rises to 99 percent in 2021) for the rest of the contract, in which case the PV discount rate of the payments for 29.92 years (29 years and 11 months) will be as shown in Table 3.

Based on the assumption above, the PV discount rate is 13.27 percent, the IRR is 13.89 percent (calculated on a weighted average basis since cash flows increased after Year 9 based on a 96.7 percent deviation rate), and the ROI is 17.37 percent. Here we have to read the numbers from the Government's point of view. The numbers above mean that the Government will keep the contractor compensated enough so that its initial calculations of IRR (17.43 percent) and ROI (17.58 percent) come through. In order to do that the Government will pay an annual rate of 17.37 percent interest on a Euro basis (since the money goes to the contractor, it is a cost to the Government).

Annual payment	5,952,618
Period (years)	29.92
Present value of payments	(50,029,207.56)
Payments till June 30, 2021	51,093,308
Remanining payments	209,215,250
Total	206,308,558
Discount rate	13.27%

¹² These data came from a medyascope piece by Aytuğ Özçolak, available at <https://medyascope.tv/2021/10/07/hata-payi-yuzde-99-kutahyada-1-milyon-317-bin-yolcu-garantisi-verilen-zafer-havalimanini-su-ana-kadar-7-bin-397-kisi-kullandi-sirkete-ilk-dokuz-ay-icin-52-milyon-euro-odenecek/>.

What If the Deviation Rate Is Higher? If the deviation rate rises to 99 percent, then the total payments from June 30, 2021, until the expiry date (March 31, 2044) of the contract will exceed €208 million, as shown in Table 4.

According to the assumption in Table 4 (with a deviation rate of 99 percent), the PV discount rate will be 13.27 percent, the IRR 13.91 percent, and the weighted average ROI 17.44 percent. Here again, reading the numbers from the Government's point of view, we see that if the Government keeps the contractor compensated enough that its initial calculations of IRR (17.43 percent) and ROI (17.58 percent) result, the Government will have to pay an annual rate of 17.44 percent interest on a Euro basis.

What If the Government Used a Cost-Plus Arrangement Instead?

The Turkish Treasury, within the framework 2010 program, realized its third issue in the markets. After a three-year interval, it issued Euro-denominated bonds of 1.5 billion with a 10-year maturity. The interest rate realized was approximately 5.20 percent.¹³

What if the government had made a cost-plus agreement with the contractor, assuming a 10 percent or 20 percent profit margin paid as a one-shot cash disbursement, and kept the cut of the ticket revenue for itself? In that case, the Government would have paid €60 and €70 million to the contractor with a 10 percent and a 20 percent profit margin, respectively. The savings to the Government with 38,000 passengers per year would have been around €200K. An annual €200K cash savings would not have justified a €50 or €60 million investment. However, considering the Government's 5.2 percent Euro borrowing rate and comparing the cost of ROI 17+ percent

Annual payment	5,952,618.00
Period (years)	29.92
Present value of payments	(50,000,000.00)
Payments till June 30, 2021	51,093,308.00
Remanining payments	208, 000, 000.00
Total	259, 093, 308.00
Discount rate	13.27%

¹³ See "Hazine euro cinsi 10 yıl vadeli borçlandı" (bigpara, Apr. 14, 2010), available at https://bigpara.hurriyet.com.tr/haberler/genel-haberler/hazine-euro-cinsi-10-yil-vadeli-borclandi_ID704237/.

interest (from the earlier discussions), this would have been a lot cheaper for the Government. With a 96.7 percent deviation rate, the total cash out would have been around €259 million. With a 99 percent deviation rate, the total cash out would have been around €260 million. Either way the Government would have saved between €189 million (for €70 million payment and 96.7 percent deviation rate) and €200 million (for €60 million payment and 99 percent deviation rate).

The Investment From the Contractor's Viewpoint

This section discusses the matter from the contractor's point of view. Let's assume that the contractor had €50 million to invest. What investment alternatives were available back then? According to the European Central Bank, the 10-year government benchmark yield was 4.3 percent in November 2011 and 2.24 percent in November 2012.¹⁴ Turkish Eurobond interest was 5.2 percent. On the U.S. Government side, borrowing rates were even lower in 2011 and 2012. By undertaking this project, the contractor made an additional return of 12.38 percent (i.e., 17.58 percent - 5.2 percent) on its investment on a Euro basis.

What if the contractor had borrowed €50 million to finance the project? Eurozone bank interest rates were below 5 percent during 2011 and 2012, and they continued to drop in the following years. If the contractor borrowed the money from Eurozone banks, it would have paid 5 percent interest and made 17+ percent ROI from the project. That would have left the company with 12+ percent leverage on a Euro basis.

Turkey's International Standing on Transparency and Borrowing

At the initiation of the project (2012 year end), the Turkish CDS (Credit Default Swaps) rate was 3 percent,¹⁵ and at the time of this writing (January 2022), it was 5.71 percent.¹⁶ Turkey's risk premium has almost doubled in the 10-year period.

According to Transparency International CPI (Corruption Perception Index), Turkey had a 49 percent score and ranked 54th among 176 countries

¹⁴ See European Central Bank, "Parameters and Transformations," available at https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=143.FM.M.U2.EUR.4F.BB.U2_10Y.YLD.

¹⁵ See Reuters Staff, "Turkey CDS Rise to Highest Since January 2012-Markit" (Reuters, Sept. 14, 2015), available at <https://www.reuters.com/article/turkey-cds/turkey-cds-rise-to-highest-since-january-2012-markit-idUSL5N11K1IE20150914>.

¹⁶ See "Turkey 5 Year CDS—Historical Data" (World Government Bonds), available at <http://www.worldgovernmentbonds.com/cds-historical-data/turkey/5-year/#:~:text=The percent20Turkey percent205 percent20Year percent20CDS, percent2B86.4 percent25 percent20during percent20last percent20year>.

in 2012. In 2021, Turkey's score dropped to 38 percent, with a rank of 96 among 180 countries.¹⁷

The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing, and financing proliferation of weapons of mass destruction. In October 2021 FATF downgraded Turkey to a so-called grey list for failing to head off money laundering and terrorist financing, a decision that could further erode foreign investment after a years-long exodus. Turkey, the largest country to be downgraded, needs to address "serious issues of supervision" in its banking and real estate sectors, and with gold and precious stones dealers, FATF President Marcus Pleyer told a news conference.¹⁸ As Turkey loses its transparency, its risk premium increases. The subject of this article is one of those cases that led to Turkey's risk premium going up and its transparency score going down.

Conclusion

Governments are non-profit organizations. Governments' duties include constructing roads, railways, electricity networks, airports, canals, sewage systems, and dams. They provide the infrastructure for the public good. These projects might be very costly, and private sector companies can't be attracted unless they charge a large amount per metric of the investment project. Governments undertake these projects and finance them by taxes or by borrowing or a combination of the two. This article describes one of those types of investments undertaken by a private sector company with no risks attached. In other words, the Government says that "it is an infrastructure public work and you are the lucky company that I am inviting you without any bidding." Turkish Law of Bidding (law # 4734) has been changed 190 times since its inception in 2003. The item that changed the most is the "exceptions."¹⁹

The contractor's assignment to the project was one of the exceptions in the law which required no bidding. As mentioned in the introduction, the three neighboring cities' total population (1,683,033) being the denominator and the guaranteed passengers of Year 10 and onwards being the numerator (1,317,733), the ratio of guaranteed passengers to the total population of

¹⁷ See "Transparency International Turkey" (Transparency Int'l), available at <https://www.transparency.org/en/countries/turkey>.

¹⁸ See Jonathan Spicer, "Finance Watchdog 'Grey Lists' Turkey in Threat to Investment" (Reuters, Oct. 21, 2021), available at <https://www.reuters.com/business/finance-watchdog-grey-lists-turkey-threat-investment-2021-10-21/#:~:text=Other percent20FATF percent20grey percent20listed percent20countries,portfolio percent20flows percent20are percent20also percent20hit>.

¹⁹ See Başak Kaya, "İhale Kanunu 191. kez değişiyor" (soxcu.com, Oct. 13, 2020), available at <https://www.sozcu.com.tr/2020/ekonomi/ihale-kanunu-191-kez-degisiyor-6078261/>.

these three cities is 78.2 percent. That is, it was supposedly expected that the number of passengers flying from Zafer on an annual basis would be more than 78 percent of the population of the three cities. That calculation had no basis in reality as shown by the departing passenger numbers, and the fact that none of these three cities is a tourist attraction, like Bodrum, Antalya, or Istanbul. Besides, these cities have low per capita income compared to big cities located on the seashores.

Corruption appears in a number of forms in any country—bribing government officers, money laundering, misrepresentation of government reports and statistics, and so on. Turkey’s reputation has been tarnished in recent years. This in turn led to lessened foreign direct investment (FDI) in Turkey and worsened Turkey’s credibility.

Turkey’s lira edged near to its record low, triggering direct central bank intervention selling dollars, after ratings agency Fitch revised the country’s outlook to “negative” from “stable” over risks created by recent monetary policy easing.²⁰ As can be inferred from the above, all statistics about Turkey are converging on a downward slope. This is not a coincidence. It is a consequence of corruption.

Governments should be accountable. They have to be able to justify their performances in public settings, or corruption starts and spreads throughout the country. Here’s hoping Turkey gets out of this morass in the near future!

²⁰ See Ece Toksabay & Ezgi Erkoyun, “Turkish Cenbank Again Stops Lira From Sliding to Record” (Reuters, Dec. 3, 2021), available at <https://www.reuters.com/markets/europe/turkish-lira-weakens-after-fitch-downgrades-outlook-negative-2021-12-03/>.



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