

Regulatory reform in Turkish energy industry: An analysis

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Abstract

The Republic of Turkey has initiated an ambitious reform program in the most important segments of her energy market; which requires privatization, liberalization as well as a radical restructuring of these industries. However, there is no consensus that the measures introduced are optimal. The present article attempts, first, to evaluate the regulatory framework created by the laws of 2001 in terms of economic efficiency considerations; and second, to determine what still needs to be done to improve the current situation. The paper not only provides an analysis of these reforms but also lists some policy suggestions. The study concludes that despite relatively good legislative framework, in practice, the reforms in Turkey are far from ideal as they are mainly in the form of “textbook reforms”; and therefore a significant amount of work still lies ahead of Turkey to set up a fully fledged energy market.

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1. Introduction

The Republic of Turkey (hereafter Turkey) has initiated a major reform program of the regulatory framework surrounding the most important segments of her energy market; namely, electricity, natural gas, petroleum and liquefied petroleum gas industries. The reform program entails privatization, liberalization as well as a radical restructuring of the whole energy industry. Also, an autonomous regulatory body, Energy Market Regulatory Authority (EMRA), was created to set up and maintain a financially strong, stable, transparent and competitive energy market.

Although there exists a huge literature on market regulation; to the best of my knowledge, so far, no scholar has studied and analyzed the regulatory framework created

by the laws of 2001 in terms of economic efficiency considerations or tried to answer the question what still needs to be done to improve the current situation. The present article aims at filling this gap in the literature. Since it is obvious that the reforms will have important implications for the future of the country, the present article constitutes an important contribution not only to the existing literature but also to the energy policy formulation process in Turkey.

The paper is organized as follows. The next section presents the historical background of Turkish energy markets starting from the early 1900s up to the present time. Section 3 provides an overview of recent market reforms. Section 4 critically analyzes the compatibility of regulatory practice in Turkey with the theory of regulation. To improve current regulatory framework, next section lists some policy suggestions with crucial importance. The final section concludes.

2. Historical Background²

Hepbasli (2005) reports that in Turkey “the first electric generator was a 2 kW dynamo connected to the water mill

²An in-depth analysis of the history of Turkish energy markets is outside the scope of this article. For a more detailed study of this subject, please

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installed in Tarsus” in 1902; and, he continues, “[t]he first bigger power plant was installed in Silahataraga, Istanbul, in 1913”. The following evolution of Turkish energy market may be summarized as follows.

The Republic of Turkey was founded in 1923, and until the 1930s the electricity industry³ was heavily dependent on foreign investment as the country was trying a liberal economy. In the 1930s, there was a widespread belief all over the world in the benefits of public ownership of the electricity industry. Following this trend, nationalization of Turkish electricity industry started in 1938 and, by 1944, almost all electricity industry had been placed within the public domain.

In the 1960s, the government started the “development plans era”. The Ministry of Energy and Natural Resources (MENR) was established in 1963, and was responsible for Turkey’s energy policy. This was followed in 1970 by the creation of Turkish Electricity Administration (TEK), which would have a monopoly in the Turkish electricity sector at almost all stages apart from distribution, which were left to the local administrations.⁴

In the early 1980s, as was the case in many European countries, the Turkish electricity industry was dominated by a state-owned vertically integrated company, TEK. Starting from the 1980s, the government sought to attract private participation into the industry in order to ease the investment burden on the general budget. In 1982, the monopoly of public sector on generation was abolished and the private sector was allowed to build power plants and sell their electricity to TEK. In 1984, TEK was restructured and gained the status of state-owned enterprise.

Various private sector participation models short of privatization were put into practice. The first law setting up a framework for private participation in electricity industry was enacted in 1984 (Law No. 3096). This Law forms the legal basis for private participation through Build Operate and Transfer (BOT) contracts for new generation facilities, Transfer of Operating Rights (TOOR) contracts for existing generation and distribution assets, and the autoproducer system for companies to produce their own electricity. Under a BOT concession, a private company would build and operate a plant for up to 99 years (subsequently reduced to 49 years) and then transfer it to the state at no cost. Under a TOOR, the private enterprise would operate (and rehabilitate where necessary) an

existing government-owned facility through a lease-type arrangement (Atiyas and Dutz, 2003).

In 1993, TEK was incorporated into privatization plan and split into two separate state-owned enterprises, namely Turkish Electricity Generation Transmission Co. (TEAS) and Turkish Electricity Distribution Co. (TEDAS). However, the constitutional court of Turkey issued a series of rulings in 1994 and 1995 making the privatization almost impossible to implement in electricity industry. To overcome the deadlock; in August 1999, the parliament passed a constitutional amendment permitting the privatization of public utility services and allowing international arbitration for resolving disputes. However, during this interval, Turkey not only lost five invaluable years in terms of reform process that could never get back but also, and more importantly, tried to enhance the attractiveness of BOT projects by providing “take or pay” guarantees by the Undersecretariat of Treasury for adding new generation capacity to meet anticipated demand. An additional law, namely the Build Operate and Own⁵ (BOO) Law (No. 4283), for private sector participation in the construction and operation of new power plants was also enacted in 1997 again with guarantees provided by the Treasury.⁶ Current structure of the contracts concluded based on these laws acts as a major barrier to the development of competition in the electricity sector.

3. Recent market reforms

3.1. The definition of reform

In Oxford English Dictionary (2002), the term “reform” is defined as “[t]he amendment, or altering for the better, of some faulty state of things”. In line with this definition; in this paper, the term “reform” refers to measures introduced so as to both *amend* the previous *faulty* state of things in energy industry that resulted in the problems listed in the following section and *alter for the better* situation in which these problems may be solved. Those actions taken to postpone the problems are not regarded as reform in this paper. To put it shortly, this article only refers to the period following the enactment of 2001 laws as “reform period”. All other measures aiming at delaying the approaching energy crisis (such as BOT, BOO, TOOR schemes) do not constitute a part of “reform period” in this context.

⁵Under the BOO model, investors retain ownership of the facility at the end of the contract period. That is, it is a kind of licensing system rather than a concession award.

⁶A typical BOT, BOO or TOOR generation contract, signed between the private party and TEAS or TEDAS, includes exclusive “take or pay” obligations with fixed quantities (in general, 85% of the plant output) and prices (or price formulas) over 15–30 years. That is, under these models, the government retains most commercial risks while providing the private sector with substantial rewards. Also the situation was worse in Turkey as, in Turkish case; there was no requirement for prequalification or even for a competitive open tender to conclude these contracts (Atiyas and Dutz, 2003), which resulted in onerous terms and high electricity prices.

(footnote continued)

see IEA (2005), OECD (2002), World Bank (2004), EMRA (2003), Hepbasli (2005), Ozkivrak (2005), Krishnaswamy and Stuggins (2003); and Atiyas and Dutz (2003).

³As the reform process has concentrated around electricity industry, the main focus of the article is placed on that segment of Turkish energy market.

⁴In 1982, however, distribution was also transferred to TEK, thus making TEK a national vertically integrated monopoly fully owned by the state.

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