ELSEVIER

Energy Policy 35 (2007) 5021–5034

ENERGY POLICY

www.elsevier.com/locate/enpol

The privatization of electricity distribution in Turkey: A legal and economic analysis

Ali Ulusoy[a], Fuat Oguz[b,*]

[a]School of Law, Ankara University, Turkey
[b]Department of Economics, Başkent University, Eskişehir Yolu 20. km, 06530 Baglica, Ankara, Turkey

Received 26 February 2007; accepted 25 April 2007
Available online 14 June 2007

Abstract

This paper analyzes the recent regulatory reform in the Turkish Electricity Distribution Market from a legal and economic perspective. We highlight tensions between the judiciary, politicians and bureaucracy and discuss their economic consequences. The paper engages in a discussion of economic consequences of legal procedures. We stress interactions between legal decisions and economic institutions. The historical positions of the Constitutional Court and Danıştay (Council of State), on privatizations have been ambivalent and it is hard to qualify them as an incentive for privatization and reform, despite some recent liberal decisions. We address reasons behind their decisions and offer some suggestions toward improving the privatization process.

Keywords: Distribution; Electricity; Turkey

1. Introduction

Any regulatory system can be seen as a mixture of two components: rules of the game and the way these rules are interpreted and implemented. The first refers to the actions of the legislative body,[1] and the second refers to the judiciary and bureaucracy. When tension exists between these two components, the regulatory system—and any efforts to reform it—performs poorly. Problems of legitimacy, rising transaction costs and conflicts of interest lead to institutional failure.

The recent regulatory reform of the Turkish electricity market in general, and the distribution segment in particular, has displayed many signs of a disconnect between the legal structure and the political will to reform and privatize the industry. In this paper, we focus on the reaction of the courts to political actions and discuss economic consequences of major legal issues surrounding privatization of the electricity distribution market from a legal-economic point of view.

There already exists significant literature discussing various aspects of electricity market reform in Turkey.[2] However, little attention has been paid to the interaction between legal and economic aspects of the reform process. It is our goal to contribute to this body of literature and engage in a discussion of economic consequences of legal procedures. We stress interactions between legal decisions and economic institutions.

The article begins with a brief discussion of the concept of 'public interest' since it is crucial for any regulatory process. Next, we briefly address the case to be made in support of privatization of the electricity distribution industry. Then, we present a brief description of the changes in the legal environment within the last two decades. In the subsequent section, we turn to benchmark decisions of the Constitutional Court (CC) and the Danıştay. Last, we touch upon the legal issues surrounding

*Corresponding author.
E-mail address: foguz@yahoo.com (F. Oguz).

[1]As a well-known exception, administrative agencies have also authority to designate rules of the game under legislative body. For American Law, see Asimow et al. (2002, p. 218); French Law, see Chapus (1997, p. 57); and Turkish Law, see Gozubuyuk and Tan (2004, p. 111).

[2]See, e.g., Atiyas and Dutz (2005), Bagdadioglu et al. (2007), Çetin and Oguz (2007a), and Ozkivrak (2005) for some of the recent work on the restructuring effort.

0301-4215/$ - see front matter © 2007 Elsevier Ltd. All rights reserved.
doi:10.1016/j.enpol.2007.04.035

the process of privatizing electricity distribution through competitive, auction-style bidding.

2. On the concept of public interest

In law and economics literature, the notion of public interest is usually assumed rather than explicitly stated (Hantke-Domas, 2003). Most scholars tend to take it as something similar to market failure theory (Hagg, 1997; Ogus, 1994). The starting point of the legal-economic approach was to draw an outline of what was assumed with this 'theory'.

Public interest is usually used with respect to market failures and externalities (Hertog, 2000). In addition to these 'economic' motives, some non-economic ones also drive legal behavior. Distributional justice and paternalism may also play some role in decisions. These considerations assume that there are no public choice and knowledge issues relevant to legal decisions.[3]

The reluctance to define public interest explicitly and precisely leaves plenty of room for political and legal maneuvering.[4] This is one of the reasons why we do not find any clear description of public interest. The decisions discussed in this paper also follow this tradition. They cite the vague concept of public interest without giving a clear definition of what is in the public's interest.

Public interest theory assumes that institutions are created for public purposes, but then are mismanaged or get out of hand. This view accepts that there is no fundamental flaw with the theory, yet that the implementation of public interest through the bureaucracy is flawed.

This view does not stand well against empirical evidence. The literature on regulatory issues shows that the public decisions of bureaucrats support specific groups consistently, and create systematic wealth transfers. Thus, there must be some conceptual misrepresentation of the notion of public interest.[5]

While our goal is not to delve into these issues, there are two categorically different problems associated with the misrepresentation: knowledge problems and private interests.

To begin with, neither regulators nor courts have all the necessary information to make decisions that maximize public interest in any empirically plausible way. Epistemological problems and high transaction costs make empirical calculations of wealth maximization quite blurred. Courts use crude proxies and rules of thumbs to find the public interest. The absence of any control mechanism for CC's interpretation of public interest and the vagueness of the definition leave room for less diligence and accountability.

The second problem is about the incentives of politicians, bureaucrats, and to a lesser extent judiciary. This starts from transactions between politicians who supply policy premises and voters who seek particular policies. There is an entrepreneurial aspect to politicians. An important participant in the political market is the bureaucracy. Like politicians, bureaucrats are self-interested. Thus, they tend to be policy advocates rather than simply implementers. Bureaucrats have some control over the flow of information between politicians and voters and use their control to influence political decisions. The absence of any clear cost and benefit calculation permits bureaucrats to increase output and ignore costs. The bureaucracy, as a middleman, creates another transactions cost reducing channel for wealth transfers between interest groups and politicians.

Public interest has long been used as a rhetorical tool upon which to base judiciary decisions. In the United States, the Supreme Court used it extensively (Peritz, 1996). Similarly, CC of Turkey had recourse to it largely on economic matters. In this vein, public interest becomes an ideological tool to reach particular political goals. For politicians and the judiciary, the goal of the state is to pursue the public interest, at least theoretically. For critics, it is a fictional concept to conceal the transfer of wealth between interest group and politicians.

The concept of 'public interest' plays a central role in the regulatory reform. In the next section, we turn to arguments in favor of privatization in electricity distribution and deal with the issue of public interest more concretely.

3. Why should the distribution be privatized?

The growing empirical evidence on the inefficiency of state-owned enterprises and a worldwide trend toward liberalization were the main motivations of privatization in many developing countries.[6] Another key factor was the lack of public funds for needed investment in state-owned companies.

Turkey began its liberalization efforts in 1980 with small steps. While many attempts by various governments demonstrated an intent to privatize, there were few successes.[7] Two major factors were influential in this result. First, the expressed intent toward privatization and liberalization did not always mesh with political preferences. While politicians had long-term desires to privatize state owned enterprises, their short-term goals and bureaucratic stronghold caused them to remain tied to the reigns of economic power and potential rent sources. Secondly,

[3]The same argument can also be put forward in the case of political decision-making. While politicians usually have recourse to non-economic goals in 'explaining' their decisions, courts do not make them a fundamental determinant in their decisions.

[4]While the CC and Danıştay use public interest extensively in their decisions on privatizations, the absence of a clear 'economic' notion of public interest make different interpretations possible, as discussed above.

[5]A newer version of public interest theory leaves the old dogma and introduces some empirical content to the argument. This 'progresses' public interest notion somewhat (Rose-Ackerman, 1988).

[6]See, for example, Parker and Saal (2003).

[7]Political instability, legal uncertainties and a relatively less developed financial market played major roles on the failure (Ercan and Onis, 2001).