



Structural and regulatory reform in Turkey: Lessons form public utilities[☆]



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ABSTRACT

Turkey is one of the countries that recently initiated regulatory reform in public utilities. Although Turkey tried to introduce competition to many industries through a liberalization movement that started in the 1980s, utilities remained as monopolies until the early 2000s. In the beginning of the 2000s, reforms restructured the utilities through deregulation and competition policies and established independent regulatory agencies. Whereas the reforms have been successful in some aspects, they remain insufficient in others. This paper anecdotally investigates the effects of (de)regulation on selected public utility industries and analyzes the pros and cons of the reform process. Also, it presents a comparative analysis to better understand the current institutional and governmental issues in the reform process. The findings suggest that the recently changing stance of government towards the (de)regulatory process could thwart the success of reform.

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1. Introduction

Over the last three decades, countries throughout the world have experienced a transition to the institutions of capitalism. The transition has included two main components: structural reform in public utilities and the establishment of independent regulatory agencies (IRAs). Structural change includes both privatization and partial deregulation. In this process, public utilities like telecommunications, transportation, and energy markets that are traditionally regarded as natural monopolies were restructured and control of markets by law replaced informal and discretionary governmental interventions (Vogel, 1996; Kagan, 2007). While some believe that consumers have benefited, the process has been controversial, particularly with regard to the effects of privatization and the ongoing dominance of state-owned companies. Nonetheless, the liberalization movement has influenced the entire world. The EU (including Great Britain) followed the trend in the US (Kagan, 2007). Today, many countries continue to restructure their public utility industries and establish regulatory agencies.

In contrast to the experience of more developed countries, Turkey instituted structural and regulatory reform in public utilities

in the post-2000 period. This delay was due to institutional factors in the political and legal environment. After 1980, Turkey initiated a liberalization and deregulation movement to introduce competition to its domestic markets and to transform the Turkish economy from an import substituting economy to an export-based one. The aim was a transition to the economic institutions of capitalism. Liberalization in the 1980s did not bring about a relaxation in the traditional and statist environment because prevailing institutions were unprepared. In the 1990s, Turkey suffered from a loose political structure of coalition governments as well as resistance of the bureaucracy and judiciary to the transition. The Constitutional Court and the Higher Court of Appeals especially resisted privatization. Whereas the bureaucratic and legal institutional structures resisted change, the reform process led to a rent-seeking society rather than competitive markets (Çetin and Yilmaz, 2010a).¹ Throughout the 1980s and 1990s, network and infrastructure industries had a monopolistic market structure (Çetin and Oğuz, 2011a).

In order to restructure public utilities, the AKP government (the post-2002 incumbent government) initiated a transition from the traditional state structure to the regulatory state model in the

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¹ See Çetin and Yilmaz (2010a) for a more detailed analysis of foundations of the transition to the economic institutions of capitalism in Turkey. This book presents an institutional perspective for understanding the process of economic change in Turkey.

beginning of the 2000s. There were two main components of the transition: restructuring public utilities along the lines of other countries and establishing IRAs. IRAs in Turkey are responsible for regulation in electricity, natural gas, banking, finance, and telecommunications markets; however, there are no independent regulators responsible for transportation and environmental regulation. Many studies have been done on the processes of restructuring and regulation in Turkey (Çetin and Yilmaz, 2010a; Çetin and Oğuz, 2011a, 2011b; Atiyas et al., 2012). Also, some works have studied the transition to IRAs (Çetin et al., 2014; Ozel, 2012; Sosay, 2009).

This paper focuses on the structural and deregulatory aspects of the reforms. To our knowledge, there is not yet a comprehensive study analyzing reform across public utilities, although there are some industry-specific works.² For that reason, the paper illustrates the aforementioned points through four cases of restructuring in Turkey: airline, telecommunications, electricity, and natural gas.³ We analyze effects in terms of the government's aim to ensure competitive outcomes, such as decrease in the market shares of incumbent firms, lower prices for consumers, increased demand, and improved service through deregulation. In doing so, the paper aims to present anecdotal evidence revealing the effect of structural reform on public utilities. The main purpose is to better understand the regulatory and institutional dimensions of reform. Also, the paper introduces a comparative analysis including the pros and cons of the reforms for each industry and the current regulatory issues. Accordingly, four sections follow this introduction. The second section focuses on the deregulation movement initiated in the Turkish airline industry in 2003 as a crucial experiment in the transportation sector of Turkey. In section three, we discuss the effect of reform in telecommunications on fixed and mobile voice and internet services. Section four analyzes reforms in the electricity and natural gas sectors. In section five, we compare the successes and failures of the reform movement across the industries. Also, this section underlines the effect of the recently changing stance of government regarding structural reform on the institutional quality of the regulatory process.

2. Airline deregulation

In Turkey, transportation is an area in which the regulatory reform is weak. Although there is a partial deregulation and privatization in the airline and maritime areas: railways and highways have not been opened to competition. Recently, the government introduced a bill in parliament about the liberalization of railways. The law aims to commercialize the state-owned assets and liberalize the market. In order to attract investors, the government has fostered an enormous investment movement, which includes high-speed trains and railways. While ports and some state-owned maritime firms like IDO (Istanbul Sea Buses Company) have been privatized, some state entities such as highways and bridges could be privatized.⁴ The most remarkable case of reform within transportation is airline deregulation, which was initiated in 2003. Therefore, we focus on the analysis of the Turkish airline industry. We can sort the major policy reforms as (1) deregulation of entry into the industry in 2003, (2) privatization of THY in 2004 and 2006

through an offer to the public, (3) the construction of new airports by Build-Operate-Transfer (BOT) models, and (4) a transition to a new pricing system through two laws enacted in 2001 and 2007. While those policy reforms led to important developments (such as entry of new firms into the market, increase in the number of passengers, decline in flight prices, and the effective use of infrastructure), some problems have thwarted the success of the reform.

2.1. The effects of deregulation

Before 2003, the Turkish airline industry was dominated by Turkish Airlines (THY), a state-owned monopoly. In 2003,⁵ Turkey deregulated barriers to entry in the scheduled domestic flights. Deregulation opened the industry to competition and influenced many components, from privatization of airports and ground-handling services to route restructure and the number of firms, airplanes, and flights. While there was only THY before 2003, the number of licensed firms providing scheduled domestic flights has reached nine. While those firms obtained a license to transport passengers and cargo on scheduled and unscheduled domestic and international flights, three different firms also have the right to transport cargo only.

With an increase in the number of firms in the industry, the number of aircraft and flights has also increased rapidly. While the number of wide-body aircrafts was 150 in 2002, it is over 300 today. The seat capacity that was 25,114 in 2002 is over 50,000 today. While the number of performed flights in the first month of 2003 was 11,428, this number was 46,359 in the first month of 2014. All these developments signal the effective utilization of infrastructure that was generally idle in the pre-reform period. Under the Build-Operate-Transfer (BOT) model⁶ initiated in the scope of Law No 3996, ten new airports were constructed and their operational rights were transferred to private companies.⁷ Whereas THY only flew from two departure points to 25 arrival points before 2003, today the nine airlines fly from seven departure to 45 arrival points (DHMI, 2013).

2.2. Prices and demand

In addition to market entry, the most important apparent effect of reform is the decline in prices. Fig. 1 depicts the change in the average ticket prices by year. As seen in the figure, prices declined in the months following deregulation (in October 2003). While nominal prices have increased, real prices have continued to decline. Also, the real bus ticket prices for intercity transportation have been nearly constant in the same period and flight prices have approached bus fares leading to a substitution effect seen by the dramatic increase in domestic airline passengers as illustrated in Fig. 2.

² See Çetin and Oğuz (2007a) for electricity, Çetin and Oğuz (2007b) for natural gas, Ardiyok and Oğuz (2010) for telecommunications, and Çetin and Benk (2011) for airlines.

³ In the Turkish experience, because telecommunications, airline, electricity, and natural gas are especially crucial, we investigate the effect of (de)regulatory reform in those industries.

⁴ Although some highways and bridges were privatized in December 2012, Privatization Administration (OIB) annulled this privatization in February 2013.

⁵ USA deregulated its airline industry in 1992. EU had introduced three reform packages to construct a single aviation industry within the EU countries and to deregulate fully from 1987 to 1993.

⁶ There are many other impacts of the BOT model on the industry and the Turkish economy. While this model has provided employment for 8500 people, \$1.2 billion of investment was floated in the economy. Moreover, revenue for \$12 billion was brought in the treasury by means of privatization and transfer of rights for Domestic and International Terminals of Ataturk Airport, first and second International Terminal in Antalya Airport, and tenders for operational transfer of Sabiha Gokcen Airport. Only, the revenue that is gained by privatization of the airport terminals was \$3.1 billion. The airports in Turkey embraced a modern structure with the BOT model by prominent companies in aviation sector and without incurring a penny from the treasury (Çetin and Benk, 2011).

⁷ A new airport project in Istanbul was initiated as the biggest in the world (DHMI, 2013).

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