The political economy of electricity market liberalization: a cross-country approach

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More than half of the countries in the world have introduced a reform process in their power sectors in the last three decades. Since the 1980s, as a result of various reform processes, the structure of the electricity industry has shifted from a vertically integrated (and usually state-owned) monopoly towards unbundled (and usually privately owned) regulated utilities. In all reforming countries (whether developed or developing), reforms take place in a political economic environment and are directly affected by the developments taking place in it. There is no doubt that without political support the reforms cannot go further in any country. In most cases, the political structure of a country largely determines the extent of the reforms in that country. This paper attempts to discover the impact of political economic variables on the liberalization process in electricity markets.

We address the following research questions: (i) what is the impact of industrial electricity consumers (as an interest group) on the reform progress in the power sector? (ii) does foreign influence resulting from the dependence on foreign financial support have an influence on the electricity market liberalization process? (iii) is the ideology of ruling party and professional/educational background of the chief executive (prime minister or president) an important determinant of the reform progress? If yes, what is the direction of their influences?

Adapting a political economy perspective, this paper attempts to discover the impact of political economic variables on the liberalization process in electricity markets. Empirical models are developed using panel data from 55 developed and developing countries covering the period 1975–2010. The research findings clearly show that political variables have a significant impact on the reform progress. Consistent with public choice theory and the economic theory of regulation, our results suggest that a portion of the differences in the reform experiences of reforming countries in the past three decades can be explained by differences in the relative strength of interest groups. We find that the industrial sector has a significant impact on the pace of power market liberalization process; and as its size gets larger, so does its influence. Our results also imply that countries receiving foreign financial support are more likely to liberalize their electricity markets, which underlines the point that reforms may not be always voluntary. In addition, our findings suggest that government ideology is one of the determinants of the progress in electricity market reform process. Finally, the paper also questions whether politicians' education and profession matter for the electricity market reforms. Overall, the results show they do.