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**Public choice theory, semi-authoritarian regimes and energy prices:
A preliminary report**

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Public choice theory, semi-authoritarian regimes and energy prices: A preliminary report

Nils August Andresen*

Abstract

This paper explores some parameters that might be relevant to understand energy reform in semi-authoritarian regimes. These regimes should more easily than others, be able to overcome public resentment and implement unpopular policies such as increasing energy prices. This does not seem to be the case. On the contrary, there is a systematic bias in authoritarian and semi-authoritarian regimes in favour of lower energy prices. This bias is caused both by the corrupt environment of those regimes, and by the behaviour of the public, who, deprived of their opportunity to have meaningful elections, are left with only the possibility of protest. As public protest on some occasions in the past has led to regime change, it is imperative for the regime to avoid deep-rooted discontent in the population. Low energy prices is one way of avoiding this.

Key Words

Public Choice Theory, Russia, energy reform, semi-authoritarian regimes

JEL Classification

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1 Introduction

Several years with rising energy prices, as well as concerns about climate change, have brought energy sector reform to the centre of the political agenda in countries around the globe. As it becomes increasingly clear that countries must increase energy efficiency, price reform, removal of subsidies, and, in some countries, introduction of energy or carbon taxes, are seriously being considered as policy options in countries accustomed to low energy prices.

These questions loom large in Europe and the United States. However, the question of reforming energy prices is perhaps even more acute in many emerging and developing economies, where energy consumption is rising and where energy prices often have been low – and subsidized.

Some of these countries are major energy exporters – Russia, Nigeria, Iran and Mexico are examples – some are importers, such as China and India. Among both groups, there are democratic regimes and less democratic regimes. When trying to understand the prospect for – and the process of – energy price reform, both the characteristics of the regime, and the country's position in the global energy market seem to be relevant.

This paper explores the parameters that might be relevant to understand energy reform in semi-authoritarian regimes – regimes that are not the totalitarian or strictly authoritarian regimes of old, but where electoral democracy still plays only a minor role in the constitution of government. Russia is a prime example of such a state, as shown by the latest presidential election: All the suspense was associated with whom *Putin* would elect as his successor; not with whether the people would then support his decision or not.

The theoretical discussion focuses on semi-authoritarian states in general, while the majority of examples will pertain specifically to Russia. I do so using a framework originally developed to understand policy-making processes in democratic regimes, namely public choice theory.

The aim of the paper is to investigate factors that should be looked at in order to understand Russian energy price policies, their interrelationship with one another, and to what extent these factors are specifically Russian or part of more general patterns.

However, the discussions are mostly theoretical: an empirical investigation into Russian realities remains beyond the scope of the paper.

2 Public Choice Theory in semi-authoritarian states

Whereas much economic analysis either works within a given political framework, or explicitly recommends the political framework which would be optimal, it has become clear that to understand long-term economic development, it is necessary to understand political developments, since they shape the incentive structures for actors across the economy. This field – based on the need for economists to be able to analyse at least those aspects of the polity that have the most immediate consequences for economic actors – was spearheaded by James Buchanan and the public choice school of thought.

Traditional political science analysis often operates with the government as *one* actor, and often assumes very simple objectives for the government, for example to maximize public welfare; to stay in power; or to strengthen the international position of the country.

The basic premise of Public Choice Theory (PCT) is that the government is not one body which acts in order to maximize public welfare, but rather a set of diverse agents who act for their own specific reasons. The basic idea is that the actors in the polity, whether voters, interest groups or politicians, are, in essence, the same actors as those subject to economic analysis, that is, more or less rational individuals who aim to maximize their own utility. However, where as these self-interested actors in the realm of the market place – given certain (albeit often unrealistic) assumptions – produce socially desirable outcomes, the same cannot be taken for granted in the realm of the political process, since the incentive structures governing behaviour are different.¹

Studies in the structures that influence economic outcomes through political behaviour and, thus, economic policy, have mainly focused on democracies. The interplay between voters – or just the public in countries that are not electoral democracies – politicians and interest groups in authoritarian regimes is much less studied. The reason

is that it is the democratic way of governing that creates incentive structures that influence policy-making. Autocrats, it has been assumed, can do whatever their whims dictate, and thus do not lend themselves readily to systematic study of the interaction between policy-makers and the public.

In public choice theory, there are two main mechanisms through which society influence politicians and the policy-making process: In the first, politicians bribe voters with policies in order to get their vote. In the second, special interest groups bribe politicians to get the policies they want.

The first mechanism is explained by one of the central tenets of Public Choice Theory – politicians tend to do almost anything to come to or stay in power: But limited by the rules of democratic government, the most important means at their disposal is the policies they promote. The policy mix of a political party will thus tend to be designed to attract the broadest possible coalition of self-interested voters.

Public choice theory usually operates with a clear distinction between politicians – who are active and formulate policies – and voters, who are passive, and merely respond to policies by giving their support to a party or switching to another.

However, the exact processes differ according to the party system. For instance, in a two-party system, such as in the US and partly in the UK, the concept of swing voters becomes extremely important, whereas this concept less role in the fractioned party systems common in European – here, the concept of swing parties instead become important.

The second mechanism is explained by a simpler factor: Greed. Since Public Choice Theory assumes self-interested political agents, proponents of the theory expect politicians to seek to convert the power they hold as decision-makers into some other benefit, predominantly monetary.

To be sure, this description of politics is not exhaustive of the democratic process. Voters have the choice not only between existing parties and policies – they can also engage more directly in the political process. Albert Hirschman pointed out that, when

¹ Buchanan, James, 1986, Nobel Prize Speech delivered 8 December 1986, http://nobelprize.org/nobel_prizes/economics/laureates/1986/buchanan-lecture.html

dissatisfied, voters have the choice between withdrawing their support for a party – *exit* – and engaging with the party in order to change policies – *voice*.²

In authoritarian and semi-authoritarian regimes, the exit option is perhaps of less consequence. In China there are no alternative parties to which one may switch allegiance. In Russia opposition parties hold seats in parliament, however, in the face of ruling party dominance this opposition appears purely nominal and accordingly, exit might be an option of no real consequence. However, at least in semi-authoritarian regimes, where all opposition is not immediately silenced, voice still remains an option for those who are dissatisfied. Voice can take the form of engagement in the political process within the governing structures, or through direct forms of protest, such as street action.

Thus, while exit by hypothesis provides too weak of an incentive in semi-authoritarian states, incorporating voice as a strategy for the electorate might allow the application of PCT concepts also to semi-authoritarian states.

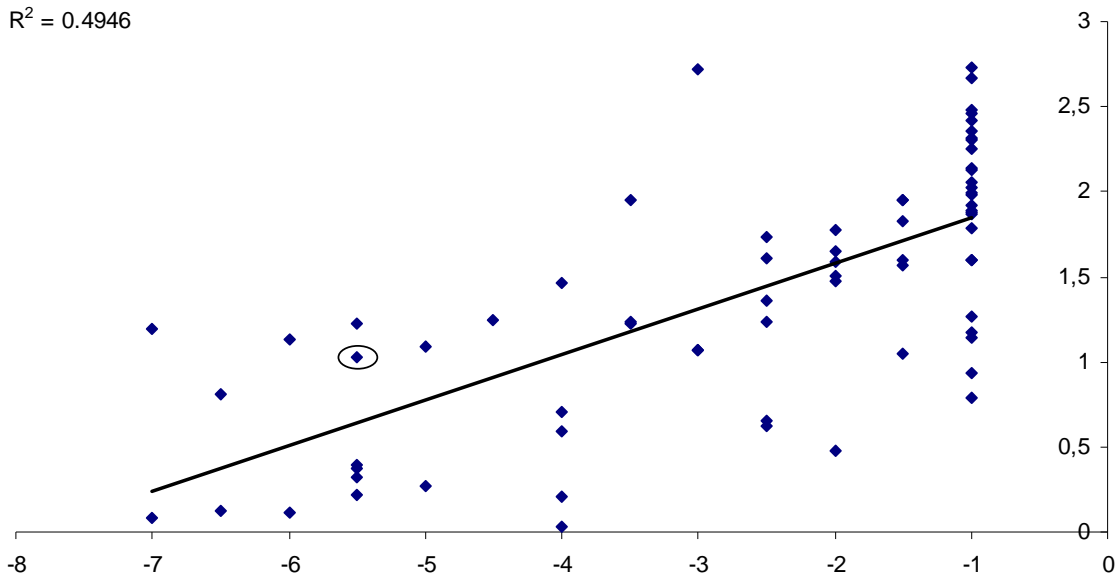
3 Energy sector policies in semi-authoritarian states

Applying PCT to semi-authoritarian regimes (i.e. assuming that governments take into consideration public opinion) may seem paradoxical: These regimes should more easily than others, be able to overcome public resentment and *implement unpopular policies*. *Thus, if for example the leadership believed subsidizing energy prices not to be in the national interest, they should swiftly move to abolish subsidies and increase prices.*

However, in practice the opposite seems to be true. As we see on Figure 3.1, there is a relatively strong relationship between degree of political freedom, as measured by the Freedom House index, and petrol prices. Energy prices, of course, include more than petrol prices, notably natural gas and electricity, but petrol prices represent the indicator which most easily can be compared across countries and regions, since it oil is a global commodity and price differences owe more to regulation for that product.

² Hirschman, Albert O., 1970, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Harvard University Press.

Figure 3.1 The relationship between degree of political freedom and petrol prices. Freedom House index (here inverted, from -7 to -1 with -1 as the most democratic), petrol prices at pump, USD/litre



Sources: Freedom House, <http://www.freedomhouse.org/template.cfm?page=410&year=2008>, Various sources on petrol prices collected at Wikipedia http://en.wikipedia.org/wiki/Petrol_prices

Note: Two extreme outliers, Sierra Leone and Eritrea are excluded from the sample. Russia is marked with a circle – note that while Russian petrol prices are relatively high, gas prices rank among the lowest in the world.

One might argue that many of the oil exporting countries – that generally have low domestic energy prices – are also more authoritarian. However, the oil exporters that are democratic, e.g. Norway and Canada, have high prices. Moreover, the relationship continues to exist even among oil importers.

Alternatively, consider the strong correlation between GDP levels and democratic rule, there might be a causal relation between GDP levels and energy price policies.

Still, it seems interesting to explore whether the correlation suggests that there might exist a direct influence between the form of government and energy policies, and, if so, through what mechanisms such an influence occurs. Part of the paradox thus remains.

If we think in terms of rational actors, it seems clear that those politicians who choose to spend treasure to keep energy prices low believe that they have something to gain from it. If we relax the rationality assumption to allow for altruism, that gain might be that they believe low, regulated energy prices to be in the national interest, however defined. However, since the end of communism, there is little reason to believe that there are

systematic variations in perceptions in this field between democracies and authoritarian regimes.³

If they do not believe it to be in the national interest, the explanation must lie elsewhere. The two most likely alternative candidates as a rationale for keeping energy prices low are *corruption* that enables the leadership of autocratic regimes to gain monetarily, or *concern about regime legitimacy* and the wish to stay in power. These are the two mechanisms that will be explored in this paper.

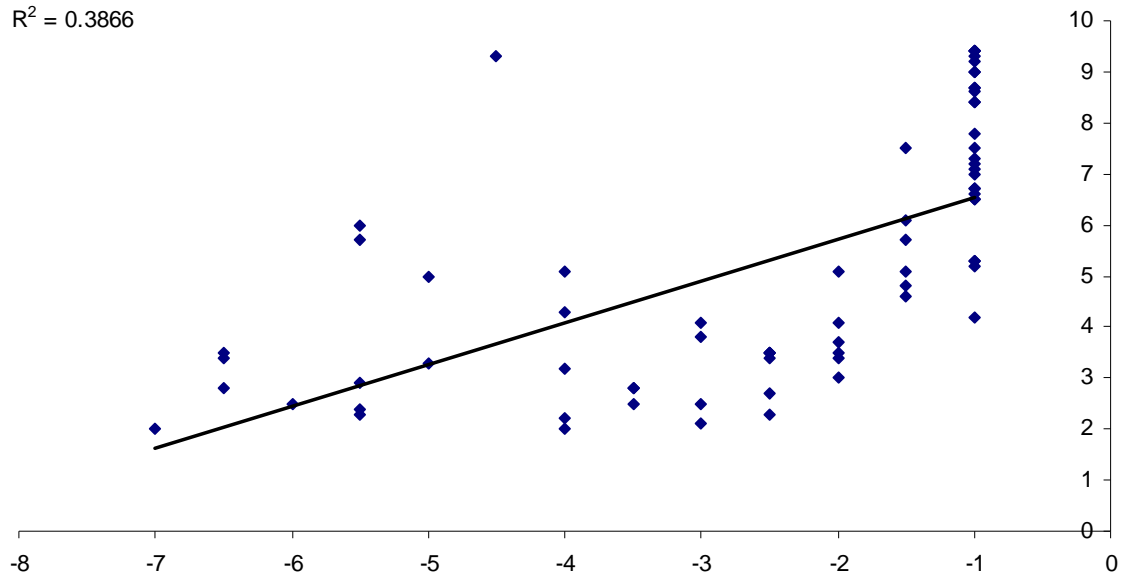
Corruption and authoritarian regimes

Let us start with the proposition that policy-makers in authoritarian regimes have more to gain monetarily from subsidies than their colleagues in democratic regimes. Such monetary gain would most likely come from some form of corruption or illicit activities. For the purpose of this paper I propose the following relation: Authoritarian regimes foster corruption, and the corrupt environment in turn fosters unnecessary and harmful regulations resulting in subsidized energy prices.

We can start pursuing this argument by looking at the correlation between autocratic regimes and corruption. Using the Freedom House index and Transparency International's index of transparency, it appears to be a strong connection between the two, as shown in Figure 3.2:

³ The arguments in this paper do not depend on market prices for energy being optimal in any sense; the interest is primarily in the price policies difference between authoritarian and democratic governments. However, some of the arguments do suggest that at some point the economic incentives and the cost of subsidies are suboptimal.

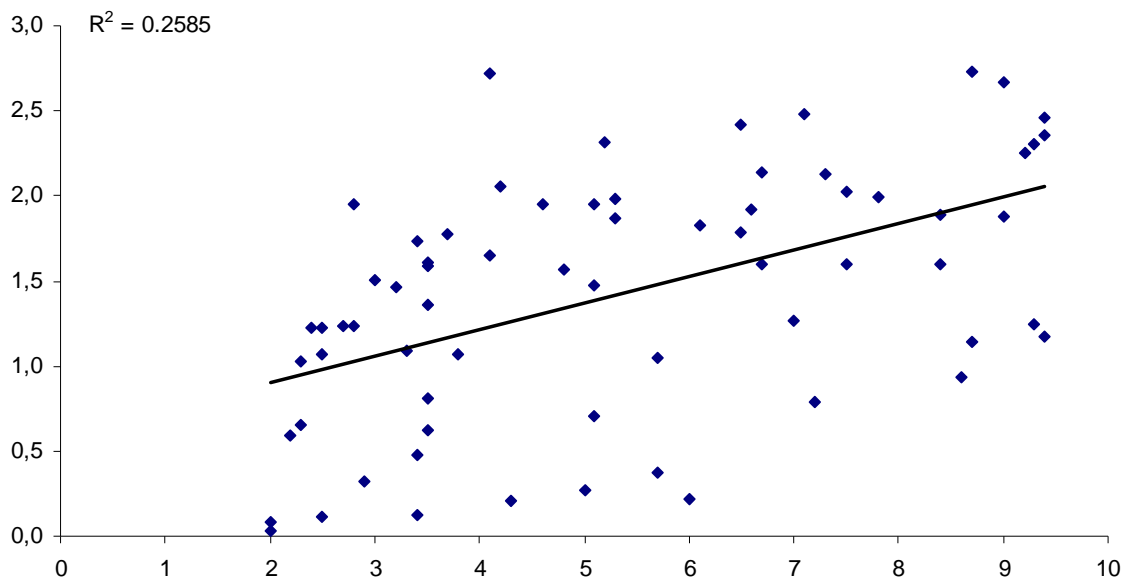
Figure 3.2 *The relationship between degree of political freedom and transparency*



Sources: Freedom House, <http://www.freedomhouse.org/template.cfm?page=410&year=2008>, Transparency International, http://www.transparency.org/publications/publications/annual_reports/annual_report_2007

The data further shows a correlation between transparency and petrol prices, as shown in Figure 3. It should be pointed out that petrol prices might not be the best indicator to measure, as those able to bribe would not be regular car drivers, but rather large corporations or other powerful interest groups. In Russia, for instance, petrol prices are relatively high; however, domestic gas prices, which are much more important to the industrial sector, remain very low and heavily regulated.

Figure 3.3 *The relationship between corruption and petrol prices.*
Corruption: Transparency International index (1 worst, 10 best)



Source: Transparency International,
http://www.transparency.org/publications/publications/annual_reports/annual_report_2007

That authoritarian regimes are more corrupt is, of course, no surprise, and is well known. The possible reasons are many, and include the lack of independent media, the lack of an independent police force, and the lack of a clear need to be perceived as incorrupt. However, our interest here is not corruption in itself; rather, it is the effect of a corrupt environment on energy policy.

There are two major possible effects. The first one involves direct bribes: Those with an interest in low energy prices can pay politicians to enact regulations to lower prices or use taxpayers' money to give subsidies. Such bribes are likely if the structure of the economy is such that important and powerful industrial actors in fact do gain from low energy prices, even if this imposes a cost on the overall economic performance of the country. In Russia, several strong, private corporations in power intensive industries might seek undue influence on energy policy. Gas export, on the other hand, which is the industry that would benefit the most from market prices on gas, remains a government monopoly. Although there are private shareholders in Gazprom, the policy of the company is closely linked with the policies of the government. Thus, the company has less incentive to *bribe* politicians: it is governed by politicians.

The second effect has to do with the way price regulations facilitate shady business deals. If domestic and international prices differ significantly, and the government

controls access to export markets, government officials can either directly buy cheap domestic energy products and resell them expensively, or they can be bribed to sell the right to do so to someone else. In Russia, the export tax on oil is the kind of regulation that would allow for such behaviour.

Energy policies and legitimacy in semi-authoritarian regimes

However, even in less corrupt regimes, there remains a strong link between authoritarianism and petrol prices. Qatar, which is graded as “not free” (score 5.5) by Freedom House, is a prime example: Even given the country’s relatively uncorrupt environment (score 6 on the Transparency International index), petrol prices stand at a low 0.22 USD per litre.

This observation leads us to the second proposed mechanism for the causal relationship between authoritarianism and low energy prices: Legitimacy, and the wish to stay in power. The point of departure for this line of reasoning is that although the mechanisms through which the population influences decision-makers are different in authoritarian regimes compared to democratic regimes, this does not imply that there is no influence. The protests over the monetization of certain social benefits that occurred in Russia in 2005 are a relevant example.

From the point of view of an semi-authoritarian regime, the calculation might be that given the relative futility of oppositional activities, very few people will do so – unless they are severely disaffected. However, such disaffection has occurred repeatedly through history, and, at least from the time of the revolution in France, has contributed to many regime changes. The clue, then, is to avoid that people become severely disaffected, and to be seen as legitimate by the people.

Of course, what constitutes legitimacy varies significantly with time and place. However, the proposition here is that there is a systematic difference between democratic and authoritarian regimes in this regard, and that energy prices play a more prominent role in relation to the legitimacy of the regime in the latter than in the former. The reasoning behind this proposition has to do with the concepts of “exit” and “voice”, and the different role they play in electoral democracies and authoritarian regimes respectively.

In electoral democracies, the most powerful tool of the voters is “exit” – if their party behaves in a way they perceive as detrimental to their interests, they withhold their vote. To be sure, not all voters feel that their voice matters – but politicians behave as they do, because the vote of the swing voter *does*. Of course, vocal protests might also matter in electoral democracies, but hardly in the same consistent way as the threat of being removed from office. My hypothesis is that it takes much less of a disagreement to use the exit-strategy than use voice: Voice is used when basic needs or values are threatened; exit is used when someone else offers a better overall package.

“Voice” also plays a role in electoral democracies, although usually exercised by a small minority. Since electoral democracies, in general, have vibrant civil societies, all concerns of voters are subject for public debate. Those who lose out if special interests secure favourable regulations can voice their opposition, through organizations or competing political parties. Thus, even if many people in democracies also would prefer low petrol taxes – and occasionally protest rising prices as fiercely as their brethren in authoritarian regimes, other groups – environmentalists, other tax payers – also engage in the public discourse. Politicians who propose subsidies to the energy sector are forced to explain how they would cover the expenses. That some people use their voice option enables other to make an informed choice about whether or not to exercise their exit option. Political parties trying to maximise their vote must appeal to a number of different voter groups. Since it does not take much policy disagreement to trigger exit, political parties must try to accommodate many different groups and find reasonable compromises. Those with differing agendas, different interests, different perceptions and different preferences thus compete in the public sphere, but in a way that often leaves the loser with more than nothing. This latter fact also reduces the likelihood of voice being taken to its more extreme form – open protest.

In authoritarian regimes, on the other hand, much fewer topics are subject to public discussion. There are no real political alternatives for those who prefer a different foreign policy, welfare policy, or environmental policy. Exit is not a meaningful strategy for expressing political discontent. This is per definition true even in authoritarian regimes with formally democratic election, or what I call semi-authoritarian regimes.

What the leaders of such regimes must avoid is less exit, as in the case of electoral democracies, than excessive voice in the form of protests. In *semi*-authoritarian regimes,

where there are formal elections, but where the results are given, the government must of course pay some attention to the electorate *qua* electorate. However, since there are no real political *competition*, this attention takes on a different form compared to electoral democracies, and seem to resemble what the government must do to avoid excessive voice. Not all topics, however, seem to have the potential to trigger voice in the form of protest against the regime. Thus, there is reason to hypothesize that bread and butter issues, that have immediate impact on people's lives, become more central to the legitimacy of the government in authoritarian polities, precisely because they seem to be able to mobilize masses.

Of course, whether and to what extent specific bread and butter issues are potential hot-button issues, depend on the specific circumstances in different countries. The whole nature of the relationship between the government and governed comes into play: How is legitimate government constituted? How is political society constituted? What is the role of economic issues in constituting a legitimate government? And, not least: What is the role of energy in economic issues?

4 Russia – according to theory or *sui generis*?

If we look at Russia specifically, there is reason to expect that the general mechanisms that I propose as possible mechanisms explaining the difference between authoritarian and democratic regimes in energy policy are at work. However, they might not provide the whole picture.

Firstly, there is reason to suspect that many government officials – possibly even at the top level – gain monetarily from oil and gas trading schemes, facilitated by price regulations. Although it is by definition difficult to produce conclusive evidence of shady business, there is no lack of speculation both about shady gas and oil trading schemes that are facilitated by export taxes and the monopoly position of Gazprom. However, these regulations are not necessarily the reason for low prices. Firstly, petrol prices are, in fact, not that low by international standards (see Figure 3.1). Secondly, gas prices, which are indeed low and tightly regulated, are at much lower levels that would be required in order to facilitate corruption.

Secondly, there are strong lobby groups that would have much to gain from low energy prices. In particular, the power intensive industry gains from low gas and electricity

prices. Given a generally corrupt environment, such groups would be in a position to bribe officials to influence policy. For the power intensive industry, of course, the lower the prices, the better. However, there are also important industries that would gain from less regulation and higher prices, notably non-fossil power producers and private oil and gas companies.

Although corruption and the incentive structures that derive from it might play a role in Russian energy politics, it is not immediately clear that the corrupt environment points directly to the actually existing policy structure.

Thirdly, therefore, we turn to the concept of the legitimacy of power and the role of “voice” in semi-authoritarian regimes. Indeed, Russia displays a to-the-point example of how voice in the form of protest has been much more powerful than any threat of electoral set-ups in forcing the government to change policies. The case in point is the protests over monetization in 2005 – and the reaction of the government – highlight a number of points. Firstly, these protests mark the only real political disturbance during the Putin years. None of all other potentially divisive political issues – such as the war in Chechnya, support for the US after 9/11, WTO membership, Kasyanov’s resignation, the new Land Code, the new tax code, none of these issues fostered an environment as hostile to the government as did the monetization of benefits. Furthermore, on none of these issues does the position of the Russian government seem to be much influenced by public perceptions.

That the fear of public unrest might indeed play a role also with regard to energy prices was indicated in 2007, when precisely such directly influenced petrol price behaviour in Russia, as the government threatened to introduce direct regulation if retail prices continued to rise in the pre-election period in 2007 and 2008.⁴ And that same fear most likely plays a significant role in influencing any deregulation of prices for electricity and natural gas. The argument here is that what the government feared was less to lose the election – which would have been unlikely under any scenario – but rather protests or other forms of unrest which could delegitimize elections or which could serve as a base for future opposition to the government.

⁴ Source: Retuers, <http://uk.reuters.com/article/oilRpt/idUKL2866042720070502>

So far, we have discussed the generic features that one would expect to pertain to a semi-authoritarian regime. The argument is not only that most Russians would like to see their energy bills remain low, as this is the case in most democratic regimes too. Rather, the argument is that this wish, in the semi-authoritarian context of the Russian polity, influences decision-making in a different way compared to democratic polities.

However, the role that energy prices might play as a hot-button bread and butter issue, must also be seen against the backdrop of specific Russian history, for two important reasons:

Firstly, an interesting question in the Russian context is to seek a better understanding of the specific price levels – for different products – that trigger, or that the government fear might trigger, popular unrest. As mentioned, whereas natural gas prices and electricity prices are very low indeed, petrol prices are closer to the international average.

Secondly, even if the features of authoritarian government in their own right might explain why the population's *ceteris paribus* preference for low energy prices affect policy more in Russian than in democratic countries, that does not imply that those preferences are, in fact, identical in Russia and in other countries.

For both these reasons, ideographical factors connected to Russia's Soviet past matter. Of course, energy prices were very low in the Soviet Union. However, there was an important psychological distinction between petrol on the one hand and natural gas and electricity on the other already then. Since Lenin famously proclaimed that communism is "socialism plus the electrification of the country", electricity and heating were seen as a central part of what the government was meant to deliver. Petrol, on the other hand, was associated with personal cars, which long remained a luxury consumer good, for which people had to wait years in lines to acquire.

The Soviet experience thus might go some way to explain the difference between petrol on the one hand and natural gas and electricity on the other; and it might suggest that low energy prices were seen as a more central government task in the Soviet Union than in most other countries. To be sure, in the Soviet system, *everything* was, essentially, a government task. Still, it seems clear that energy was perceived differently from many other government functions. After the collapse of the Soviet Union, energy prices

continued to be regulated. Thus, the shock of price liberalization which affected most commodities and forced Russians to rethink their view on goods, prices, and the role of government, did not apply to natural gas and electricity.

I started out this exploration by stating that there is little reason to expect that there are *systematic* variations in perceptions among politicians in democracies and authoritarian regimes when it comes to what constitutes optimal energy prices. However, that does not imply that there cannot be ideographic variations. For instance, there is every reason to believe that the Putin government believes in a very large role for the state in the energy complex, also a means of national strategic development. For some politicians and economists, this involvement may indeed include significant price regulations.

Prospects for policy changes

This understanding of the factors affecting energy price policy begs the next question: What is the prospect for policy changes? Naturally, such changes would need to imply that some of the parameters listed here change. Change could come from within, or it might be triggered by outside events.

Starting with the regime itself, it could change in the direction of a more democratic regime where multi-party elections feature prominently. If so, the cost of subsidizing energy prices would likely receive more scrutiny from tax payers than today.

Secondly, the population might change their attitude to what constitutes a legitimate government, or energy prices could become less – or more – important to their political calculations.

None of these changes seem to be imminent in Russia, but they remain distinct possibilities over the long run. However, two other factors seem to merit attention. Firstly, increasing global energy prices changes the cost-benefit calculation of the leadership, as the cost of subsidies increases. For energy exporters, a tighter global resource situation also changes the strategic considerations. Moreover, increasing global energy prices might also change the competitiveness of the domestic power intensive industry, which might therefore need less subsidies than before – depending on the price conditions competitors face. Over the long run, increasing global energy prices might also affect the industrial make-up of the country.

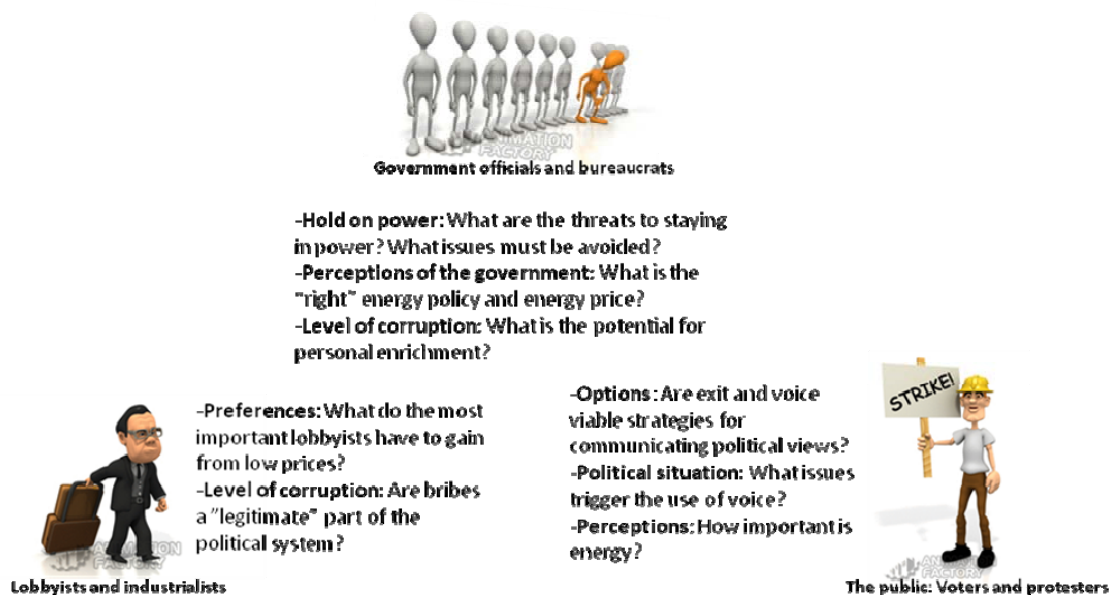
Secondly, the government’s perception of what constitutes a good energy price policy might change. Not least in Russia, where there are significant generational differences among economists and political scientists, this might be of some importance.

5 Conclusions and implications for further research

This paper has tried to spell out some of the theoretical background for thinking about energy price policies in semi-authoritarian regimes in general, and Russia in particular. The argument has been that, from a PCT perspective, there is a systematic bias in authoritarian regimes in favour of lower energy prices. This bias is caused both by the corrupt environment of those regimes, and by the behaviour of the public, who, deprived of their opportunity to have meaningful elections, are left with only the possibility of protest.

Future research on public choice in Russia and its consequences for energy policy should elaborate on the mechanisms of public influence suggested in this paper. In particular an investigation into the relative strength of exit and voice across regime types, fully democratic, semi-authoritarian and authoritarian, is required. Including an assessment of energy prices’ potential for affecting public reaction will provide the background necessary for adding PCT as a driving force behind Russian energy policy.

Figure 5.1 Government officials, lobbyists and the public



However, the paper further argues that ideographic factors, such as the beliefs and preferences of both the government and the governed, as well as the actual economic structure of the country, matter. In Russia, there might be reason to believe that these factors also pull in the direction of lower energy prices.

Finally, the paper speculates about how one could think about how low-price energy policies in semi-authoritarian regimes might change. Two possible change-factors in Russia might be new ideas and beliefs in the government itself; or changing cost-benefit analysis resulting from changes in global energy prices. Furthermore, all these issues need to be addressed empirically.