In line with the institutional economic theory on the “depoliticization” of decision-making, the Russian electricity-market reform announced the creation of an independent regulator of the wholesale electricity market: the Market Council. Although Russian electricity law establishes the “self-regulating” nature of this institution, in practice, the Market Council remains subject to direct control, as exercised by the Ministry of Energy. This lack of independence seriously limits the credibility of Russian electricity and energy investment law. It increases the risk of “politicized” decisions affecting investments, e.g., the risk of interference with the price of electricity to please consumers in the short term. In contrast to the regulatory structure governing the EU Internal Electricity Market, the main tariff authority in Russia—the Federal Service for Tariffs—is part of the executive branch of government. This exposes investors to the risk of non-cost-reflective tariff levels, i.e., to serious difficulties in recovering the capital—and possibly even the operating—costs of their investments. Federal control over tariff decisions also affects the possibility for regional authorities in Russia to pursue ambitious energy-efficiency policies. Guarantees of regulatory independence—possibly inspired by the EU approach—are needed to facilitate investment decisions in the modernization of the Russian energy sector.

The liberalization of electricity markets is a process generally characterized by the creation of specialized and independent regulatory authorities.¹ These authorities are charged with the task of providing expertise and taking technical regulatory decisions that implement the general legal framework governing the electricity industry (e.g., decisions on tariffs and network issues). They are often created as separate entities from the industrial players and from the executive branch of government in order to exercise their functions independently from private and political actors. One of the main reasons underlying the delegation of regulatory functions to independent regulatory authorities in general is to “depoliticize” regulatory decisions, i.e., to ensure that these decisions are shielded from short-term political pressure and intervention.

This “depoliticization” of the technical decision-making process would, according to the institutional economic literature, support the credibility of a government’s commitments.\(^2\) In turn, the enhanced credibility and regulatory commitment would stimulate private investment in the electricity market.\(^3\) It is generally accepted in the literature that “[t]he creation of independent regulators who apply stable and predictable rules is a way of encouraging investment”.\(^4\) This positive correlation can be seen particularly in the liberalized electricity sector\(^5\) and in the utilities sector in general. According to

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4 Phedon Nicolaïdes, “Regulation of Liberalized Markets: A New Role for the State? (Or How to Induce Competition among Regulators)”, in Geradin et al., op. cit. note 2, 30.

5 Based on an extensive review of the literature on the effectiveness of utility regulatory agency and governance arrangements for the electricity sector, Stern and Cubbin conclude that “independent regulatory agencies are associated in developing countries with higher investment (e.g., mainline penetration rates) and faster productivity growth either directly and/or by augmenting the effects of liberalization/competition and privatization”. John Stern and John Cubbin, “Regulatory Effectiveness: The Impact of Regulation and Regulatory Governance Arrangements on Electricity Industry Outcomes”, The World Bank Policy Research Working Paper (March 2005) No.3536, 53. See, also, Ashley Brown, John Stern and