



SESSA WP 4

Industry Restructuring, Market Power and Workable Competition

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Point of departure and major issues

- Point of departure
 - Competition leads to lower price-cost margins and more cost-efficient production and supply
 - Major issues
 - Threats to workable competition
 - Market power
 - Electricity market impact of climate policy and large scale introduction of renewable electricity
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Market power

- Definition

- The power to profitably raise the market price above the competitive level

- Observations on market power

- Potential market power may or may not be exercised
 - The *Lerner index* [(price-marginal cost)/price] is a measure of exercised market power
 - Several measurement problems
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Market power in wholesale markets

- As generation and load have to balance in real time *pivotal* generators have very significant potential market power
 - Pivotal generators need not be big (in terms of annual production or market share)
 - But big generators are pivotal more often than small generators
 - Thus there is a positive relation between concentration and potential market power in wholesale electricity markets
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Market power mitigation in wholesale electricity markets

- Splitting of major incumbents and reduced barriers to entry of new generators
 - "More players in a given market"
 - Integration of previously separated local, national or regional markets
 - "Larger market for a given set of players"
 - Key issues: Inter-connector capacity and pricing
 - Forward contracting
 - "More markets for a given set of players"
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Best Practice 1

- The Nordic countries: Market integration and forward contracting
 - No significant exercise of market power
 - Features of the Nordic wholesale market
 - Inter-connector capacity sufficient for regional price equalisation most of the time
 - Given that the Nordic market is well integrated the degree of concentration is relatively low
 - Stringent market rules make relevant information available for all market participants
 - Significant share of hydro power
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Market power in retail markets

- Low barriers to entry suggest that retail markets are "contestable" and thus free from market power problems
 - But high actual and perceived switching costs may protect incumbents and give them market power
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Best Practice 2

- Successful retail competition in Norway
 - Low price-cost margins and cost-reflective prices
 - Features of the Norwegian retail market
 - Free entry of new suppliers
 - Low degree of concentration
 - Transparent prices and contract conditions
 - Free choice of supplier
 - No charge for switching supplier
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Conclusions

- Market power:
 - Is a potentially serious threat to competition in European electricity markets
 - But can be successfully mitigated by market integration, particularly if supported by forward contracting
 - Retail competition can work without excessive costs and to the benefit of consumers
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