

Issues in Market Design

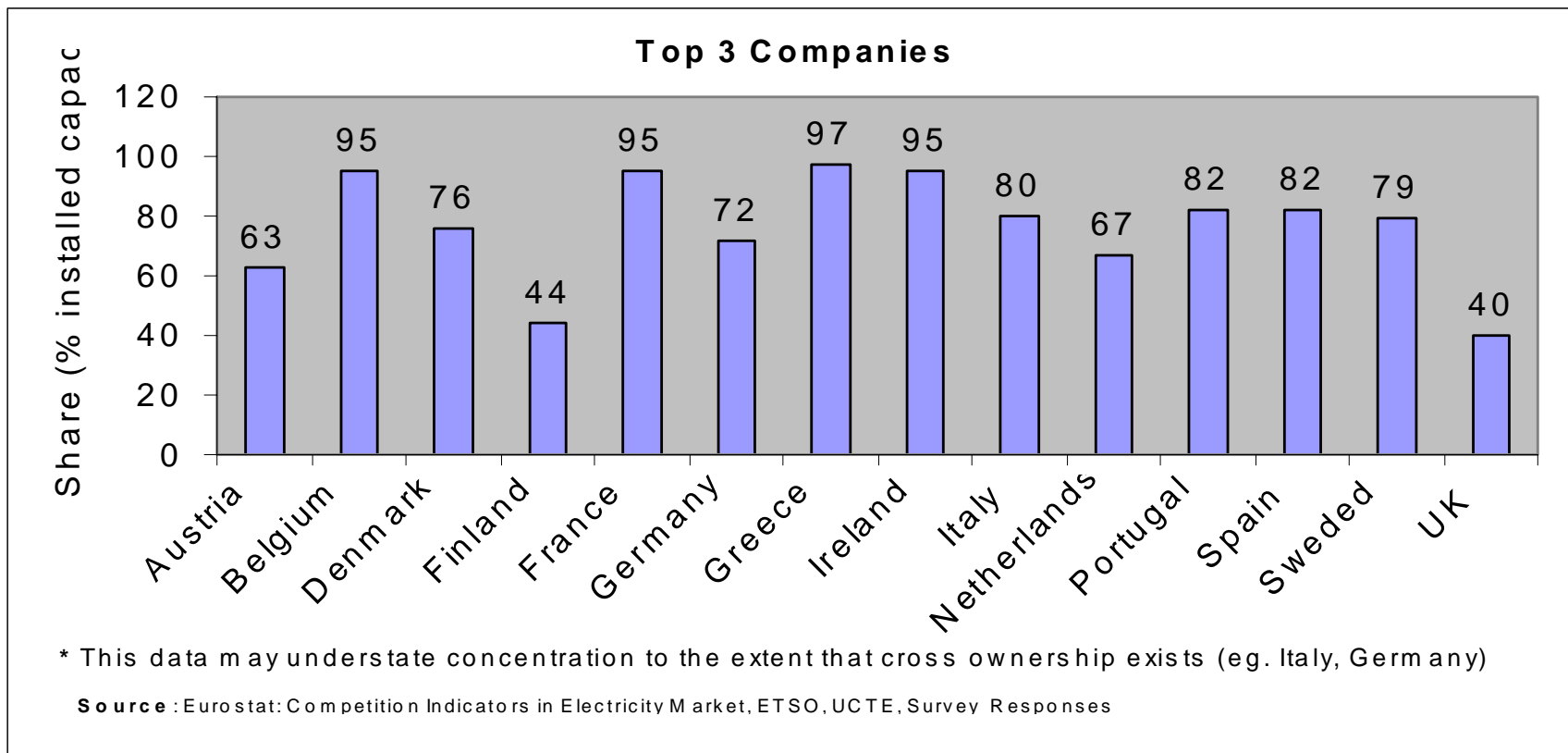
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Some key issues

- Concentration – design doesn't matter much in absence of real competition
- “Sustainability” – need a design that will last, bearing in mind “special characteristics” of electricity
- Incentives for efficient investment (especially in light of need for environmental regulation)
- Transparency and governance issues

Concentration



(refers to 2002/03)

Concentration

- Regulators have limited ability to address concentration issues
 - Publicise concerns
 - High quality analysis of competition and effects
 - Maximise transparency
- Increased interconnection helps
 - Efficient congestion management to maximise available capacity (e.g., netting)
 - Incentives for TSO to maximise capacity (not just interconnectors)
 - but new build not always realistic or most efficient solution
- Minimising barriers to entry also important
 - Effective unbundling and non-discriminatory access are essential
 - But entry will be a slow and uncertain cure for monopoly

Sustainable design

- Special characteristics of electricity
 - Short run inelasticity
 - High tendency to political intervention
- Market must be able to cope with “extreme” conditions
 - General concerns re manipulability underlay switch away from E&W Pool
 - E&W balancing mechanism designed with those concerns in mind
 - Ongoing concerns about market abuse when capacity is tight led to the (failed) Market Abuse Licence Condition
 - Risks of moral hazard when SO is generator of last resort
- Importance of forward contracting
 - Avoid restrictions (as in CA)

Incentives for efficient investment

- Regulatory certainty
 - Major uncertainties at present in GB from implementation of environmental legislation (LCPD, EU ETS)
- Efficient design of environmental policy to minimise distortions
 - Example: specified level of support (e.g., in €/MWh) for renewables preferable to “must-run” status

Incentives for efficient investment

- Locational charges for transmission
 - E&W transmission charges are £9/kW/yr in north, negative £7/kW/yr in south-west (i.e., generators *paid* to transmit)
 - Reflects long-run marginal cost on system with strong north-south flow
 - Clearly right in principle to also incorporate transmission losses into charging, but has proved highly controversial in GB context
- Risk of ill-conceived measures aimed at ensuring security of supply
 - E&W Pool capacity mechanism involved large payments to generators, to little effect
 - No evidence that such mechanisms have been effective
 - Careful analysis before making policy

Transparency and governance issues

- Large informational asymmetry between regulator and regulated firms
- Transparency is key
 - Regulator can see what's going on
 - Expose actions of dominant firm to other market players
 - Regulators therefore need information-gathering powers
- Governance should allow market participants to propose changes, regulator to make decisions (subject to statutory constraints)
 - E&W Pool governance arrangements were too inflexible, dominant firms could block changes

Conclusion: relevant issues

Market Design Issues

- Transparency
- Flexible governance
- Market abuse concerns
 - Design of balancing mechanism
 - Load pockets
 - Etc
- Congestion management
- Locational pricing

Related Issues

- Concentration
- Unbundling
- TPA
- Efficient design of environmental regulation
- Incentives for network efficiency

A large, central version of the ofgem logo is positioned in the middle of the slide. It features the word "ofgem" in white lowercase letters on a rounded orange background. The background of the slide is a light blue gradient with a faint image of electrical outlets and a person's face.

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