Do We Need Capacity Instruments?; and if yes, Which Ones?

Institutional Economic Analysis on the Rationality and the Realization of Capacity Instruments

Prof. Dr. Christian von Hirschhausen, Prof. Dr. Thorsten Beckers, Albert Hoffrichter
Berlin University of Technology, Workgroup for Infrastructure Policy (WIP)

Based on joint research with Jan Siegmeier
Main Theses

1) The traditional (academic) discussion about capacity markets is not particularly useful in the (German) debate of sector design in the energy transformation („Energiewende“)

2) The discussion needs to build upon generally agreed objectives (which are unclear at present): for example security of supply; consumer interest; environmental objectives

3) There is a general consensus that capacity instruments are NOT needed in Germany in November 2011 with the sole objective of security of supply

4) The discussion in Baden-Wuertemberg, which is the driver of the current discussion in Germany, hovers around an ill-defined problem and misses the breadth of options on the table

5) The rage of options stretches from strategic reserve to „vertical integration“, with advantages and disadvantages

6) Since i) the problem is not well defined; and ii) there is no urgent need for action, we should take the time to research the topic in-depth, before deriving concrete policy conclusions

7) In the meantime, the best thing to do is to avoid short-termist action, such as implementing de-facto capacity instruments for power plants in the „Kraftwerksinvestitionsprogramm“ (Brunsbüttel, Profen, others)
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Objectives and evaluation criteria

**Effective achievement of objectives**

**Short- and long-term security of supply**

**Limiting consumer payments (long-term perspective)**

- Welfare effect of instrument choice
  - Risk bearing and risk costs
  - Incentives to efficient investments from system perspective
  - Incentives to efficient dispatch decisions
- Distributive effects
  - Generators - consumers
  - To distinguish: neighbour countries’ consumers and generators

**Constraint: Avoid opportunistic behaviour towards sunk investments**

**Compatibility with environmental objectives**
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Despite nuclear phase-out no „power gap“

Results of recent studies: No „power gap“ at least until 2020

- ENTSO-E (2011)

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Where is capacity required? N – S – E – W?
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Overview of capacity instruments

1) Strategic reserve
2) Operative reserve
3) Capacity payments
4) Capacity certificates
   4.1) Capacity tender
   4.2) Capacity requirements
5) Capacity options
   5.1) Capacity options tenders
   5.2) Capacity options requirements
6) Regulatory procurement contracts
7) Vertical integration
   regulator – generation
Capacity options tender – evaluation

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7) Vertical integration regulator – generation

Fundamentally
- Possible to meet security of supply objective
- Flexible coverage of residual load can be realised efficiently due to incentives for availability
- Consumer payments can be limited to any preferred degree
- Positive welfare effects resulting from risk allocation: aggregated demand side can take risk better than single suppliers
- High complexity

Depending on design
- If only new utilities are addressed, pitfalls regarding opportunistic behaviour towards old investments have to be avoided by an appropriate design
- Hazard of market power problems if tendered, especially if:
  - existing utilities participate
  - spatial differenciation
  - technological differenciation
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Thank you!

Contact
Thorsten Beckers, tb@wip.tu-berlin.de, Tel. Nr. 030-314-23243 / 0163-8479465
Christian von Hirschhausen, cvh@wip.tu-berlin.de, Tel. Nr. 030-314-25048
Albert Hoffrichter, ah@wip.tu-berlin.de, Tel.-Nr. 030-314-78773