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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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Working Party No. 2 on Competition and Regulation

Executive Summary of the Roundtable on Competition in Energy Markets

Annex to the Summary Record of the 73rd meeting of Working Party 2

28 November 2022

This Executive Summary by the OECD Secretariat contains the key findings from the Roundtable on Competition in Energy Markets held by Working Party 2 on 28 November 2022.

More documents related to this discussion can be found at
www.oecd.org/competition/competition-in-energy-markets.htm

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Executive Summary of the Roundtable on Competition in Energy Markets

By the Secretariat¹

On 28 November 2022, Working Party No. 2 on Competition and Regulation held a roundtable to discuss competition in energy markets. Considering the background note prepared by the OECD Secretariat, the written contributions, as well as the discussion by the delegates and the expert panellists, the following key points emerged:

1. High energy prices are a major concern for households and businesses, but the events driving high prices are outside the remit of competition authorities.

The high prices observed on energy markets are the result of external shocks due to the Covid-19 pandemic and Russia's invasion of Ukraine. Shortages in supply and excess demand have led to record energy commodity prices, the impact of which has been felt worldwide. High natural gas and electricity prices have had significant impacts on inflation, economic growth, living standards, and wider policy goals such as decarbonisation.

Energy prices dropped considerably at the onset of the Covid-19 pandemic in March 2020, due to an unprecedented fall in economic activity and transport. In the second half of 2021, there was a rebound in energy prices, driven by the resumption of economic activity and travel. Both oil and natural gas prices exceeded pre-pandemic price levels, with European natural gas prices reaching all-time highs, causing record-high wholesale electricity prices.

While natural gas prices have risen across Europe, the degree of increase in electricity prices has varied across countries. Countries relying on natural gas for (peak) electricity generation and with more limited electricity interconnections have seen the largest price increases. Countries less reliant on natural gas power plants and having more electricity interconnections, such as the Nordic countries, experienced smaller price increases.

2. Governments have introduced a range of policy measures to address market shortages and contain the impact of high prices on households and businesses.

In response to the crisis, governments have introduced policy measures to ease gas shortages and the impact of high bills on businesses and households. Some countries have introduced mechanisms to cap the price of natural gas and electricity paid by consumers, with different methods of implementation. The fiscal cost of price caps has been much higher than anticipated, largely because energy prices have been more expensive and for longer than anticipated. Several countries have adopted redistributive measures, either direct payments targeted at low-income households or, to save the time to administer targeted payments, given to all households.

Several measures have been implemented to influence supply and demand:

- On the supply side, there have been investments to increase import capacity for liquefied natural gas (LNG). New floating LNG terminals are being built, and Europe is diversifying away from its previous main source of supply, namely

¹ This executive summary does not necessarily represent the consensus view of the Working Party participants. It does however identify key points from the discussion at the Roundtable, including the views of the expert panellists and the participants' oral and written contributions.

Russia. Given the profits made by oil and gas producers and electricity generators, some governments have introduced windfall taxes.

- On the demand side, there have been measures to reduce dependence on fossil fuels, to invest in renewable infrastructure, and to incentivise customers to reduce consumption. There has also been substitution from natural gas towards oil and coal.

Europe has been hit especially hard by the crisis, but European markets have readjusted to the new situation. In 2022 Russian gas flows decreased, but storage was filled by significantly reducing demand and increasing LNG imports. There has also been an important reshuffling in electricity flows thanks to market forces. This has shown the importance to keep markets working and the risks that interfering with electricity and gas prices can create in terms of security of supply.

3. Competition authorities have been very active during the crisis, with some expressing concerns that the energy crisis will have a lasting effect on competition and liberalisation of energy markets.

Competition authorities have been active during the crisis, including by providing opinions on planned policy measures and recommending pro-competitive adjustments. For instance, one of the measures implemented in the OECD was to fix the reference price applicable to the natural gas used to produce electricity. While this was a temporary measure, there was a risk that it would distort price signals, which in turn would provide less incentives to reduce natural gas consumption. Similarly, retail price caps have often been criticised as they inhibit demand adjustments, such as energy conserving behaviour and energy-efficient investments. Conversely, measures that provide vulnerable households with income support do not distort the marginal price of energy and are seen as more efficient.

In some countries, the process of retail liberalisation slowed down as a result of the crisis. In some cases, households were still under a regulated tariff regime and the timetable to allow competition in that market segment was delayed. In other countries, the government intervened to freeze prices in the liberalised market and some suppliers left the market. Overall, some competition authorities reported concerns that the crisis would delay the liberalisation process.

4. Many competition authorities carried out market studies to investigate price increases, especially in the fuel market.

Some agencies were formally tasked with specific monitoring work but most of them acted within their own initiative. Market studies typically did not find that energy suppliers had engaged in anti-competitive behaviour. For instance, a study of the coal sector concluded that the increase in coal prices was linked to a shortage of coal. The selling prices of coal were going up proportionally to the increase in the purchase prices by depots from suppliers or importers, while there was no significant increase in profit margins. In the fuel sector, an OECD authority found that the bulk of price increases at petrol stations was due to higher international price indices for diesel and petrol.

5. Decarbonising the energy sector, along with other parts of the economy, is essential to fight climate change and to transition to Net Zero.

Increasing the share of electricity from renewable energy sources and managing electricity markets with a high share of renewables poses several challenges.

- Competitiveness of renewable energy: the cost competitiveness of renewable generation has improved in the last decade but increasing costs of industrial materials and of transport have reversed the long-term trend of decreasing costs. At

current prices, the need for subsidies is clearly declining. However, withdrawing subsidies too quickly could undermine the investment needed to meet Net Zero targets. Investment in renewable energy have substantial lead-times and require a longer payback period than fossil fuel projects.

- Price formation in electricity markets: as the proportion of renewable energy in the generation mix increases, the marginal pricing model may no longer be feasible. Currently, most wholesale electricity markets set clearing prices that reflect the short-run marginal cost of the last plant dispatched in the merit order; this is typically a gas, coal, or oil-fired generator. With more renewable energy, renewables will more often be the marginal plant leading to low and sometimes even negative wholesale power prices. But if low prices occur for long periods of time, renewable generators will not be able to generate enough income to cover the cost of their investment. In addition, the intermittency of renewables means even systems with plentiful renewable capacity need conventional generating capacity on standby, to avoid blackouts when renewable energy is not available. There is a significant market design challenge around how to ensure remuneration of such capacity. Delegates flagged some investment projects in batteries in the pipeline.
- Stranded assets risk: if governments restrict the use of fossil fuels, there will be assets that cannot be utilised and therefore cannot earn an economic return.
- Link between domestic renewable and global fossil fuel prices: higher levels of renewable energy in domestic electricity generation should reduce the link between domestic energy prices and global energy prices – and reduce energy dependence on exporting countries. In the longer run, this could alleviate some of the geopolitical tensions experienced so far in connection with fossil fuels. Looking ahead there is an increasing need on improving cable technology so that power can be transported over greater distances.

6. Redesigning electricity markets to facilitate the Net Zero Transition is mainly a task for policy makers and energy regulators but competition authorities' advocacy may also be required.

Delegates discussed some of the challenges faced in the transition and the need to advocate for pro-competitive solutions to these challenges. The challenges included incentivising investment to reach Net Zero targets, the risk of high prices when demand can only be met by conventional producers with high marginal costs, and the importance of investment in the transmission grid to accommodate renewables.

Clarity about the phasing out of fossil fuels and about government-funded projects can help provide a stable investment environment and lead to more renewables. When the government issues licences, such as for offshore wind farms, it is important that the contracts have an appropriate level of risk sharing between the state and the companies involved. If the financial risk is too high, there will be insufficient interest for private investment.