

TABLE OF CONTENTS

| | | |
|----------|---|-----------|
| 1 | EXECUTIVE SUMMARY | 9 |
| | Impact of Market Liberalisation on Generation Costs | 9 |
| | Investment in Generation Capacity in Competitive Electricity Markets | 10 |
| | ■ Determinants of Investment | 11 |
| | ■ Prices in Oligopolistic Electricity Markets | 11 |
| | ■ Minimising Risk in Electricity Investments | 12 |
| | ■ Input Fuel Prices and Diversity | 12 |
| | ■ Dynamics: the Impact of the Business Cycle on Investment | 12 |
| | ■ Reserve Generating Capacity and Capacity Payments | 13 |
| | ■ Transition Issues: Regulatory Risk | 14 |
| | The Role of Governments | 14 |
| | Global Energy Investments | 15 |
| 2 | IMPACTS OF ELECTRICITY MARKET LIBERALISATION ON GENERATION COSTS | 17 |
| | Introduction | 17 |
| | Market Liberalisation | 18 |
| | Transparency of Public Policy Objectives and Costs | 20 |
| | Allocation of Risks | 22 |
| | Investment Costs | 27 |
| | ■ Emphasis on Economic Designs | 28 |
| | ■ Improved Use of Generation Capacity | 29 |
| | ■ Repowering | 31 |
| | ■ Competitive Procurement | 31 |
| | ■ Cost of Capital | 32 |

| | |
|---|-----------|
| Operations and Maintenance Costs | 35 |
| ▪ Labour Productivity | 35 |
| ▪ Operating Productivity | 37 |
| Fuel Costs | 38 |
| Separation of Functions | 41 |
| Conclusions | 41 |

3 INVESTMENT IN POWER GENERATING CAPACITY IN COMPETITIVE ELECTRICITY MARKETS **43**

| | |
|---|-----------|
| Introduction | 43 |
| Investment in the Past | 45 |
| ▪ How Investment Decisions Were Made | 45 |
| ▪ Investment in the Past: Results | 49 |
| Investment under Competition | 55 |
| ▪ A Framework for Understanding Investment Decisions | 55 |
| ▪ Electricity Prices and Markets | 58 |
| ▪ Investment and Risk Mitigation | 59 |
| ▪ Investment, Reserve Capacity and the Business Cycle | 62 |
| ▪ Transition Issues: Minimising Regulatory Risk | 66 |
| ▪ Diversity of Input Fuels | 67 |
| ▪ Empirical Evidence | 68 |
| Conclusions | 70 |

| | |
|--|------------|
| APPENDIX : ENERGY INVESTMENT | 73 |
| Executive Summary | 73 |
| Introduction | 76 |
| Energy Investment Needs and Benefits | 76 |
| ■ Energy Investment Needs | 76 |
| ■ Investments in the Oil and Gas Sectors | 80 |
| ■ Investments in the Coal Sector | 83 |
| ■ Investment in the Electricity Sector | 84 |
| ■ Investments in Energy Efficiency and Environment | 87 |
| ■ Benefits from Investments in the Energy Sector | 89 |
| Conditions for Investment in the Energy Sector | 91 |
| ■ Risk - Distribution and Reduction | 91 |
| ■ Access to Investment Opportunities | 92 |
| ■ Operation Once the Investment is Made | 103 |
| Recommendations to Governments on Energy Investment | 111 |
| REFERENCES | 115 |

LIST OF TABLES AND FIGURES

TABLES

| | |
|---|----|
| 1. <i>Examples of Public Policy Objectives Implemented by Utilities</i> | 21 |
| 2. <i>Typical Risks Faced by Electricity Generators</i> | 23 |
| 3. <i>Average Annual Decrease in Utility Employment Due to Market Liberalisation</i> | 36 |
| 4. <i>CEGB Estimates of NEC of Future Power Stations (Pounds/kW, 1982 prices)</i> | 47 |
| 5. <i>Capacity Growth and Reserve Margins in OECD Countries</i> | 50 |

FIGURES

| | |
|--|----|
| 1. <i>US Median Nuclear Plant Outage Times, 1989-1998</i> | 30 |
| 2. <i>Employment Trend in US Investor-Owned Utilities, 1986-1995</i> | 37 |
| 3. <i>Evolution of Generating Capacity Reserve Margins in Selected OECD Countries</i> | 51 |
| 4. <i>Generating Capacity Reserve Margins in OECD Countries (1997)</i> | 52 |
| 5. <i>OECD National Fuel Shares in Electricity Production (1997)</i> | 53 |
| 6. <i>Coal- and Gas-Fired Capacity Additions in OECD Europe, 1950-1999</i> | 54 |

BOX

| | |
|---|----|
| 1. <i>Defining Electricity for Policy Making</i> | 44 |
|---|----|