Market Efficiencies In The New Administered Markets

At the foot of LaSalle Street in Chicago's Loop stands the Chicago Board of Trade. This institution, the largest commodity market in the world, operates without the benefits of market design, computer based market settlements, or congestion management. With all of these disadvantages, why are they central example of competitive efficient markets in generations of textbooks of economics?

For those of us who have lived through the cascading failures of the California ISO and PX, Enron's recent Chapter 11, and the miserable record of Alberta's administered markets, this has become a very central concern. FERC, with the same determination that an amateur mechanic attempts to turn a bolt until it strips its threads, has announced its intention of expanding the benefits of the "market" throughout the U.S. Indeed, if FERC gets its way, we will establish three or four of the largest administered markets in the history of the world. Their judgement certainly seems questionable – imagine the Captain of the Titanic proposing to avoid the problems from his collision with the iceberg by speeding up so as to brush future obstacles from his path.

Amazingly, almost no research has been undertaken concerning whether the new administered markets are efficient. Efficiency, in this context, simply means whether these markets accurately reflect the movements of supply and demand. Put even more simply, do they send the right signals to guide consumption and new plant construction? After completing several studies for clients in the WSCC and the NPCC, the answer appears to be "no".[1]

A central feature of the seductive allure of "market design" for otherwise sober market minded individuals is the presence of the right terminology. In case where the terminology is good enough, the overall problems are easily overlooked. In New York City taxi service is competit9ive in the sense that virtually anyone can buy a taxi medallion and go into the taxi business. No one would view this solution as either efficient or good public policy. For all of the difficulty of finding a well maintained cab with a knowledgeable driver in New York, this "market" has much of the patina of a truly competitive approach – after all we can use the language of competition to describe the process – even if the result is neither competitive nor efficient.

A second reason why administered markets are not brought to account is the sheer mind numbing complexity of the administered market mechanisms. Almost two years after that fateful moment on May 22, 2000 only a few individuals can honestly say that they understand what occurred. Part of the problem is the ISO's insistence that historical data be get secret – even though all of the market participants now have a copy of every bid, change, surcharge, and completed sale price and volume.[2]

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[1]Western Systems Coordinating Council and Northeast Power Coordinating Council.

[2]The secrets of the ISO (and its lamented twin, the PX) have been distributed to all the parties of a variety of FERC proceedings, investigations by FERC, state and federal attorney generals, various legislative committees, and a variety of state agencies. When experts on California's meltdown gather, the very step is to check whether each member of the group has signed all of the appropriate confidentiality agreements. For those who have failed to do so, other avenues are available. The ISO routinely leaks secret operating details to favorites among

Sadly, only the California ISO has gone through this level of review. Some of the evidence summarized below indicates that the other administered markets are as failure ridden as the ISO. Details await lawsuits where discovery will allow us to understand the nuts and bolts of failures in ERCOT, NPCC, and MAAC.[3]

Market Efficiency In California

There is an ethical imperative to repeat the fact that capacity loads were lower and resources greater in 2000 and 2001 than they were in 1997 for the areas of California under the ISO's control. The fact that emergencies were common from May 2000 through to the onset of FERC price controls in June 2001 have led many pundits – including Harvard's noted Bill Hogan – to assume that volatile prices must necessarily mean that the fundamentals of the market had changed.

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the press, distributes secret materials through WSCC and other organizations, and routinely posts secret information on their World Wide Web site, apparently in error. In practice, all market participants now know all of the market information. Only the unfavored press and the public remain out of the loop.

[3]Electric Reliability Council of Texas and the Mid-Atlantic Area Council.