IMPULSPAPIER

Der Mittelstand.
BVMW e.V.
Bundesverband

Merit-Order adaptions effectively put the brakes on electricity prices

Key advantages of an adapted electricity market design

- Significant and rapid relief effect for all customers of electricity
- No fundamental change of the existing electricity market model necessary
- Positive impact on forward and OTC contracts
- No need to use taxpayers money
- Effective safeguarding the future of the economy in Germany and the European Union

Background

Companies in the European Union have been facing an unprecedented increase in energy prices for months. The main reason for this is the significant decline in russian gas supplies and missing short-term options allowing for a replacement of these supplies on the world market, which in combination have led to an enormous increase in prices. The current electricity market design means that high gas prices – even though this energy source only contributes e.g. to around 10 percent of the net electricity generation in Germany – determine the overall price on the electricity market. This leads to skyrocketing electricity prices for consumers and extensive windfall profits on the part of some energy companies. This imbalance must be resolved in the interests of a stable electricity market that is economically viable for all participants.

The goal must therefore be to quickly and effectively decouple the pricing of electricity from the prices of imported energy sources, especially natural gas, without profoundly interfering with the established market mechanisms (merit order model) and at the same time maintaining incentives to save energy. This way, electricity prices can be reduced for all market participants and the predictability can be improved.

Core components and operating mode of the adapted merit-order system

The requirements for a functioning electricity price brake are to reduce electricity prices quickly and effectively for all consumers, to maintain the incentive for energy savings, and to provide a stimulus for increased expansion of renewable energy.

The model originally proposed by Siempelkamp Giesserei GmbH and supported by the BVMW offers the great advantage of combining these requirements in the best possible way.

The model is based on a decoupling of the electricity price from the gas price and provides for a simple and practicable adjustment of the existing merit order system for electricity trading. The gas-induced price extremes are practically capped, so they do no longer massively increase the general price level of electricity. The costs for the small but very expensive share of electricity produced by natural gas will be financed via a levy. Overall, this will make electricity significantly cheaper again.

The proposed adjustment mechanism can be put into effect in two steps:

In the first step, a so-called synthetic electricity price will be defined for electricity produced from natural gas, based on historical average values, for example for the years 2019 to 2021. This historical average price will be increased by a surcharge to be determined politically. This surcharge is intended to ensure that an additional incentive to save energy is created, despite the reduction in price. At the same time, the surcharge will provide a stimulus for the further build-up of renewable energy capacities.

For this synthetic electricity price to take effect, gas-fired power plants must be compensated in a second step for the difference between the synthetic electricity price and the regular market price. To this end, an import levy shall be created, which shall be distributed among all consumers by means of a surcharge to be determined per kilowatt hour consumed. The levy would ensure that electricity prices fall across the board. Thus, the new electricity price level plus the levy would be significantly below current market prices.

Status: October 2022

Advantages of the adapted merit-order system

The core idea of the model is to implement a levy imposed on all electricity consumers to redistribute the cost emerging from gas powered plants on a broad basis. By reducing the price defining benchmark for all power plants, the levy will substantially reduce electricity costs for all consumers without fundamentally undermining the merit order process. The benefits of the proposed model are thus based on three pillars:

1. The proposed import levy will help to drastically and sustainably reduce the purchase cost of electricity. This will make energy purchasing more predictable again. Consumers will thus be directly relieved of energy costs and at the same time benefit from the inflation-busting effect. In contrast to the gas levy discussed in Germany, which would have created additional burdens, the proposed model can be circumscribed as a „relief levy".
2. The model continues to support the suppliers of renewable energies in particular, since the selling price to be achieved will still be far above the production costs for wind, solar or biomass, thus maintaining the savings effect for electricity consumers.
3. Long political arguments are avoided as to whether and how windfall profits can be effectively skimmed. Profits are preserved with the proposed model, but distorting excess profits are effectively curtailed. Energy wholesalers self-regulate additional costs incurred by imports and no longer pass them on to consumers.

Profit margins of several hundred percent are not necessary for scaling up renewable energy production in the EU. Instead, once electricity prices are decoupled from the price of gas, using electricity for the green transformation of the economy will be profoundly strengthened in the short and medium term. The earning power of all electricity producers is sustainably passed on and a necessary security for investments in renewable energy sources is again available for investors. The European Union will remain attractive as a business location and avoids discouraging investors through high electricity costs.

Speed is the decisive criterion in the current situation. Since the solution outlined above keeps the proven merit order system intact, it could be introduced within a few weeks – ideally as a coordinated solution on the EU-level. At the same time, adjustment in this way can also be introduced only temporarily, until the global markets for imported energy raw materials calm down.

Annex:

Fig. I: The current Merit-Order System

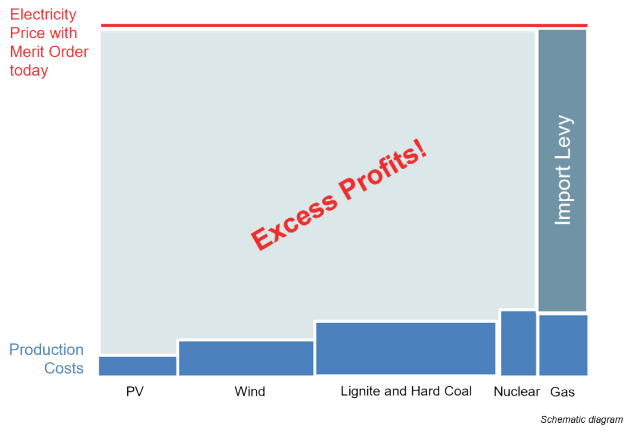
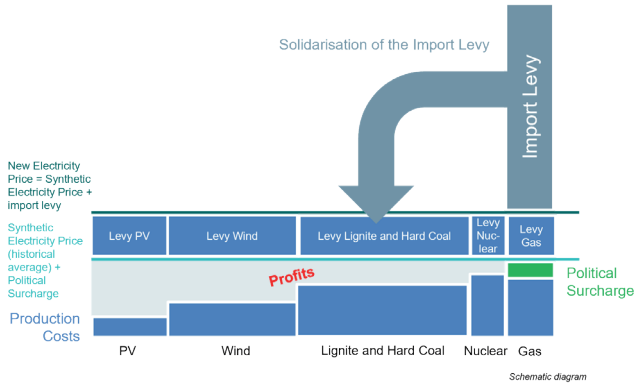


Fig. II: Adjusted Merit-Order System prohibiting windfall profits



Graphics: Siempelkamp Giesserei GmbH

The BVMW represents over 900,000 members within the framework of the Mittelstandsallianz. The association's more than 300 representatives have around 800,000 direct contacts with entrepreneurs every year. BVMW organizes more than 2,000 events per year.

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