

## Price intervention could exacerbate European energy crisis

by Christoph Maurer, Managing Director of Consentec

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*European leaders are discussing deep interventions in the energy markets. Christoph Maurer, Managing Director of Consentec, firmly believes that these reflexes are dangerous. In his position, he advocates letting market mechanisms and prices work as far as possible. As a rule, he says, the interventions are counterproductive.*

The substantial rise in prices for fuel, gas and electricity is a significant burden for particularly vulnerable consumers. Mitigation measures are therefore intensively debated by policy makers. The decision to lower fuel taxes announced by Germany's traffic light coalition was received with widespread public criticism by energy experts. The parallel discussion at European level on possible intervention in the wholesale markets for electricity and gas has gotten considerably less response.

A few weeks ago, the European Commission had already [spoken out](#) in favor of taxing away so-called crisis-related "windfall profits" from energy producers. In the run-up to the European Council meeting at the end of last week, it also issued [a communication](#) considering a price cap on the wholesale electricity markets or a price cap for fossil fuels used to generate electricity (in conjunction with fuel subsidies for the power plant operators concerned to enable them to cover their costs) as conceivable options for action.

The implementation of the latter model was specifically demanded by Spain and Portugal and supported by several other Member States. Last week at the European Council, the European heads of state and government, once again postponed the decision on the Union-wide introduction of price caps last Friday after hours of discussion. However, Spain and Portugal may receive special permission for price intervention in the short term.

Even if this buys a little time: The Damocles sword of a massive price intervention continues to hover over the internal energy market. Such an intervention would have considerable negative consequences in both the short and long term.

The high prices on the energy markets reflect the current low supply, which may become even tighter, depending also on the current conflict over ruble payments for gas. Artificial cheapening exacerbates this scarcity by influencing consumption decisions, which are very much dependent on prices, and increasing demand for energy. In a situation where energy conservation is particularly necessary, the benefits of energy saving to consumers would diminish. Moreover, the more inelastic the energy supply is (as is currently the case in the gas market), the more subsidies lead to increased rents for producers. This could mean that state money is spent to provide Russia with additional revenues.

The consequences of an actual price cap for electricity and/or gas would be even more far-reaching. Particularly in the gas sector, where gas storage facilities offer considerable opportunities for intertemporal shifts and thus also short-term increases in demand, a price cap would immediately lead to an excess demand on wholesale markets.

Supply and demand could no longer be brought into balance. Market clearing would become impossible. In such a situation, rationing of gas demand by governments would have to be implemented immediately to preserve the stability of the system. However, the necessary information and processes to efficiently implement such rationing are not available. Especially in a tight supply situation, the price mechanism has an important information and coordination function. It can reveal better, easier and

faster than any government control which uses of the scarce resource can deliver the highest economic value. To deliberately discard this information would be a big mistake.

The proposal to cap or subsidize the price of fossil fuels, specifically gas, for electricity generation appears less invasive at first glance. Indeed, it would not inevitably lead to demand rationing. Nevertheless, this proposal also has significant drawbacks.

For example, it prioritizes the use of gas for electricity generation over other uses, even though the electricity sector is one where alternatives to the use of gas exist. With a scarce supply overall, this means less available gas and greater need for adaptation, especially for gas-dependent industries.

Nor could subsidies be limited to gas as a fuel. They would also have to include other fossil fuels such as coal, so as not to shift the merit order of power plants in favor of gas and thus drive gas demand for electricity generation further upward. In fact, a situation-specific "regulatory designed" merit order would be needed, which alone seems hardly feasible in view of rapidly fluctuating fuel prices on world markets and an asymmetric information situation, for example, about the characteristics of power plants. Such attempt would inevitably lead to inefficiencies.

Moreover, such a price intervention would support the role of fossil electricity generation and weaken the incentives for all alternative approaches to resolving scarcity (and thus lowering prices) such as storage, demand response and additional renewable generation. Demand response in particular is not only about multi-year investment projects, but about tapping technical potentials in the short term.

To prevent subsidized electricity from flowing to non-EU member states, significant restrictions on cross-border electricity trade might be necessary. However, this would also reduce the possibilities for recourse to flexibility potential abroad and thus ultimately weaken security of supply.

Finally, such intervention would potentially permanently damage the role of the long-term markets. In the short term, those consumers would be penalized who traded cautiously and, for example, already hedged (at elevated price levels) for the long-term last year. In fact, these consumers would now have to pay more than players who behaved less cautiously and did not hedge their position. In the long term, there is a risk that market players will refrain from hedging on the futures market against this background, thereby perpetuating the need for government intervention.

In summary, high prices are not the current problem of energy markets. They are merely an expression of a fundamental scarcity and, at the same time, an essential means of dealing with this scarcity efficiently. Policy measures should therefore not aim at interventions in the price mechanism, but to mitigate the consequences of high prices where necessary. For example, lump-sum payments or payments based on past consumption (but not on current consumption) could be considered.

Since states do not have an acute financing problem, it is also not necessary to link relief measures with taxing away so-called "windfall profits". Determining windfall profits is difficult and prone to error (for example, if energy producers have already sold their production forward in the long term and thus do not benefit from current prices). At the same time, such interventions reduce the willingness of market players to react dynamically to (current and future) crisis situations and to contribute to easing them.

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