

Why reserves are better for Europe's electricity market than market-wide capacity mechanisms

- **Reserves function outside the energy-only-market (EOM)**, which is the central pillar of the current European market model. Power plants that benefit from support through reserves are excluded from selling their electricity either on the spot market or OTC. Thus, reserves minimise interferences with the EOM.

By contrast, market-wide mechanisms subsidise power plants that are participating in the EOM and interfere by weakening price signals. The general price level decreases, and spikes at times of high demand (so-called 'scarcity pricing') become less frequent than under a reformed EOM. Strong price signals in the EOM are needed for the cost-efficient integration of renewable energies into the electricity system. Weaker and less frequent price spikes reduce the incentives for flexible loads and production to shift. They also depress the infra-marginal rents of power plants, which exacerbates the so-called 'missing money problem'. The latter is the primary justification for the introduction of market-wide capacity mechanisms, which notably become self-perpetuating.

For example, in France, all power plants generate extra revenue by selling capacity certificates on the capacity market while simultaneously selling electricity on the EOM. In the UK, many power plants sell electricity on the EOM while simultaneously earning revenues from the capacity mechanism. Power plants consequently benefit from two income streams. In Poland, the construction of new coal-fired capacity depends on the introduction of the market-wide capacity mechanism.

Market-wide mechanisms also reduce the profitability of power plants that are situated in other member states, which exerts downwards pressure on market prices. This cross-border interference can trigger a need for capacity payments in countries that have not yet opted for these additional subsidies.

- **Reserves can be phased out more easily and thus can become a bridging solution.** Market-wide mechanisms are conceived as permanent solutions.

To preserve the EOM as a central pillar of the EU's market design, reserves need to be defined as the preferred option in the market design rules. Reserves are a temporary fix that allows states to strengthen their electricity market (EOM 2.0) through ambitious reform and, more importantly, to work towards a more European approach to supply security. Under specific circumstances, they can also be a temporary solution to tackling regional supply security problems, which can eventually be resolved through grid reinforcement.

Market-wide mechanisms reduce the need for market reform because power plants can simply rely on extra revenue from market-wide capacity mechanisms. This development undoubtedly weakens the prospects of a strengthened EOM. In addition, the need for a capacity market becomes self-perpetuating.

It comes as no surprise that countries with a long history of opposing competitive electricity markets are the strongest proponents of market-wide capacity mechanisms.

- **Market-wide capacity mechanisms weaken forwards markets.** The latter contribute to ensuring a sufficient level of capacities. The difference between spot and forwards market prices indicates the price that companies are willing to pay for a continued supply. The introduction of market-wide capacity markets both interferes with and weakens these functioning markets.

In sum, equal treatment of both models—reserves and market-wide mechanisms—would fundamentally question the current architecture of our common electricity market and represent a significant change. Because competitive, liberalised and flexible power markets favour renewable energy, this would also halt any cost-efficient transformation of energy systems in the EU.