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California Crisis: 'It Can't Happen in Germany . . . Or Can It?'

by William Engdahl

Asked if the German electricity market might be faced with a California-style power-supply crisis in the future, the National Association of German Industry (BDI) told the media, "There is no comparable price regulation in Germany." A BDI spokesman added, "Furthermore, the German electricity market is characterized by overcapacity. So, the crisis-ridden situation in California is no argument to re-regulate the German electricity market."

The gloating complacency of the BDI is part of a campaign to mislead Germans to believe that the new deregulation regime in German electricity markets is a boon to the economy. It's not surprising they do so, when you take into account, who the leading voices of the BDI are: They include many of the giant corporations which are reaping the benefits of the liberalization rules, such as E.on, Ruhrgas, and RWE, as well as industrial powers including DaimlerChrysler, ThyssenKrupp, and Siemens.

For the vast majority of the population, including *Mittelstand* (small and medium-sized) industries and private households, as well as municipal governments, electric deregulation is rapidly shaping up as a catastrophe. True, the details are different from the lunatic California deregulation model. But, they are every bit as threatening, even if it may be another year or two before the full scope of the crisis becomes obvious.

The demand for deregulation of the German electricity market comes from the European Union (EU) Commission in Brussels. Beginning in the early 1990s, Brussels bureaucrats launched a debate about the benefits of deregulating, not only telecommunications throughout the European Union (EU), but also electric power services, the very backbone of a modern industrial economy.

By December 1996, the same year that California deregulated its electric utilities, the EU passed its directive on Common Rules for the Internal Market in Electricity 96/92. This was followed in June 1998 by one on natural gas liberalization. The two directives, according to the EU, "provided the foundations for the creation of a single energy market. They have transformed the conditions under which electricity and gas trade will be carried out in the future, with a view to lead to significant price reductions across the EU, to enhanced efficiency and improved security of supply."

It sounds wonderful. It ain't.

The Brussels deregulation directives only tell part of the story. They were very general and deliberately gradual in scope. They specified that a national electricity market need open only 33% of its electricity to competition by 2003. But national governments were given wide room to apply their own rules.

Germany's Radical Change

Germany went full-steam ahead. Beginning in 1998, under the amended Energy Industry Law, Germany imposed Europe's most radical electricity deregulation, making the market 100% competitive in only two years. Under the new rules, an electric utility must offer its transmission network on equal terms to competitor use, to allow potential customers free choice. The aim, as in California, is to separate the transmission of electricity from the production by power plants. New markets in buying and selling electricity, divorced from the old, integrated production, transmission, and distribution by a single utility, are being created. Utilities are free to sell across national borders, to merge, or de-merge.

New electricity trading exchanges, like stock or commodity exchanges, are also being created, along with derivatives trading in electricity futures contracts. On March 1, the Deutsche Börse will open trading in Frankfurt of the European Energy Exchange, or EEX, whose stated aim is "to build up the leading derivatives market for electricity in Europe, in addition to a leading spot market." Germany is the largest electricity-consuming market in the EU, and German banks behind the EEX plan to make millions selling derivatives contracts to electricity customers.

Aggressive foreign electricity traders, such as Enron Corp. and Southern Company, two of the notorious companies making millions on the California crisis, have recently established operations in the German electricity trading market. The price of future electricity, as with oil today, now will be subject to the casino manipulations of mega-speculators from Deutsche Bank or Crédit Suisse, Enron or Mitsui Trading. Electricity users can no longer count on a stable, long-term fixed price.

The process is going ahead in phases. First, came a radical competition between power suppliers to sell electricity. Power companies rushed to lock up a firm new customer base by competing with other German electric companies. Even the ProMarkt retail chain began offering discounts of 20% below the normal Stadtwerke prices. They would buy the power cheaply, and run it through the local ESWE net to the customer at a tiny profit. Their costs and overhead were minimal, as they had no obligation to provide the long-term, reliable electric capacity reserves for peak demand emergencies, as older utilities traditionally did. ProMarkt was typical of the new "lean 'n' mean" free-trading innovator. Electric power supply was to be sold just like CDs or radios—buy cheap, sell dear.

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The German electric deregulation did in two years what not even Britain's electric monopoly, the Central Electricity Generating Board, dared do in eight—100% deregulation. Not only that, but the supervisory role over the process was not to be entrusted to an independent state regulator, as in most EU countries, but to the electric utilities themselves, an incestuous arrangement which has been widely criticized.

The German Electricity Association (VDEW), the BDI, and the Association of Industrial Energy and Power Industry regulate via a round table. They all are dominated by the big multinational players who stand to gain the most from deregulation.

Adalbert Ewen, head of the Christian Trade Union for Mining, Chemicals, and Energy, sees the human costs of deregulation. "Every day we see workplaces lost," he says. "Concentration in the industry is growing; the money is no longer there for investments. This is having strategic effects. Deregulation works to the benefit of the big multinational concerns, not the *Mittelstand* or normal family. This market is not transparent enough."

Opening up the German electricity market initially looked like a winner, as customers at first saw lower electric bills. That phase is rapidly coming to a close. Under the savage price wars of open competition, utilities have been forced to cut costs dramatically to maintain profits. The result has also been dramatic.

According to the VDEW, the prices for electricity have collapsed in the last two years under deregulation competition, by a total of $7.5 billion for the industry, fully 20%, which has led to enormous pressures on the utilities. To counter this, they have radically cut costs. The number of personnel employed in German electric utilities has shrunk more than 20%, from 190,000 in 1995 to 150,000, and more cuts are in store. Worse, for the longer term, this new market uncertainty has affected new investment by the utilities: Whereas annual new investment in power plants and facilities was $7 billion in 1995, that figure has fallen to $5 billion in 2000, and is estimated to fall below $3.5 billion within the next two years.

Now, the radical market competition is resulting, not in a trend toward more competition, but, as in the international oil industry, to more giant concentrations of "mega-utilities" which soon will dominate and re-monopolize the market on a private basis, without any mission to serve the general welfare which marked traditional municipal electricity works. In the past two years, more than 100 joint-venture agreements between electric utilities have been signed to defend against even more severe competition. Mergers of regional private and public utilities are the order of the day.

The giant RWE electric utility last year took over VEW AG of the Ruhr industrial region to create Germany's largest electricity group, with sales of some $43 billion and 170,000 employees. RWE has also set up an Internet-based power-trading company, RWE Energy Trading Ltd., to compete with other traders, including Enron.

This came only weeks after two other large German electric utilities, VEBA and VIAG, created another giant utility conglomerate, E.on. Immediately, both mega-utilities announced drastic cost cuts and plant closings to make their stock prices "attractive." E.on will permanently shut down 4,800 megawatts of electric-generation capacity, and RWE AG will slash 5,200 MWe over the next three years. Both call it "overcapacity." The aim is to force prices higher now that they have created giant groups to capitalize on them.

This closing of "surplus" capacity is dangerous. It reflects the shift to a bookkeeping profit calculation, which is driving the cost considerations under deregulation. No longer is an ample reserve for emergency outages or peak demand times deemed needed. Eberhard Meller, head of VDEW, stated in 1998 at a conference in Houston, Texas, "Security in the sense of uninterrupted, trouble-free supply . . . has its price. Some companies depend on 100% security of supply; others would accept less security if asked to pay less. Opportunities such as these can be exploited. The high reliability of electricity supply is undoubtedly expensive."

Greens Add to the Problem

When the German electricity deregulation was put through in 1998, oil and natural gas prices were near record lows, electricity seemed to be in oversupply, and competition was embraced as the way to make the power market more "competitive."

Now, world oil and natural gas prices are soaring to new highs, and electric costs along with them. Utilities have slashed rates in a bid to win or keep customers. Into this deteriorating situation, the Schröder Socialist-Green coalition government has dropped a huge added burden. Much as the government killed the emerging UMTS wireless communications economy by grabbing huge auction fees from the telecoms, now the Schröder government is saddling the electric utilities with a battery of new taxes to rob the benefits of the earlier cost cuts.

The Green party coalition partners pushed through an "ecological" tax, in which electric power is taxed double that for heating oil or gas. In addition, a new "renewable energy law" has been passed, to double the use of expensive and inefficient windmill, biomass, and other such "renewable" energy sources; and a third law for Protection of Coupled Electricity and District Heating, according to the VDEW, in 2000, increased costs to electric companies by $6 billion. That represented fully 80% of the cost savings achieved by earlier price reductions for electricity to customers. By 2005, the price breaks will be gone entirely, and prices will be significantly higher than before deregulation. Already last year, the average electricity price barely covered utilities' production costs.

With less plant capacity, low reserves, and no major new plants scheduled to begin construction until at least 2010, Germany, year by year, is becoming increasingly vulnerable to California-type electricity shocks.