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Germany is fighting an energy war: €200 billion will be spent on dealing with high energy prices

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In a joint statement on 29 September Chancellor Olaf Scholz, Economy Minister Robert Habeck and Finance Minister Christian Lindner announced that a financial 'umbrella' of up to €200 billion will be created for interventions on the energy market. Above all, it concerns financing the mechanism of capping natural gas prices and supporting the financing of the mechanism of capping electricity prices. All end users, i.e. both households and businesses, will reportedly benefit from that. Additional measures envisaged include individual support in the form of recapitalisation and liquidity assistance for companies that have been especially strongly affected by the energy crisis, as well as compensation for losses for gas importers that may face bankruptcy due to being cut off from Russian gas supplies. The programme is in addition to the third relief package launched mid-September (see '*Germany: third relief package for the energy crisis*').

The fund is planned for a period of two years, i.e. until spring 2024. It will be a non-budgeted fund, which means loans taken out this year will not fall under the fiscal discipline regime to be reinstated next year after the pandemic suspension. The government does not intend to create a new legal instrument to manage the money. It will use the Economic Stabilisation Fund (Wirtschaftsstabilisierungsfond, WSF), which has so far been used to finance measures to overcome the effects of the pandemic. To enable its further functioning, the Bundestag has to pass a resolution on the use of a special clause in the Basic Law on exceptions to the so-called public debt brake which is intended to limit the government's ability to take out new loans.

The document published by the government announcing the creation of a new fund did not provide details on the mechanism for controlling energy prices. The tools that are being considered include a common maximum price or quota solutions that make the final value dependent on the level of energy consumption. The subsidised price would apply, for example, to a certain amount of kilowatt hours consumed. In the case of energy consumption exceeding this bracket, the current market rates would apply. Specific proposals for a mechanism for capping gas prices are to be presented by a special expert committee by mid-October. The government will probably choose a solution that, in addition to protecting consumers from high prices, will include incentives to save energy.

Commentary

- The government's decision is a reaction to the extreme surge in energy prices in Germany in recent months and to inflation, which reached 10% in September— the highest level since the early 1950s. The situation on the gas market is particularly difficult because Germany was until recently heavily reliant on supplies from Russia. Germany is not yet able to fully compensate for its gas deficits with, for example, LNG imports, due to the lack of necessary infrastructure. This further escalates the price pressure and uncertainty for market participants. The first terminals for receiving liquefied gas in Germany are to be commissioned at the turn of 2022 and 2023.
- By allocating the spectacularly high amount of €200 billion (5% of GDP) for an intervention in the energy market, the SPD-Greens-FDP government coalition is expressing its concern about the social and economic costs of the energy crisis. Expensive gas and electricity is having a particularly tough impact on less affluent social groups and is strengthening the anti-establishment parties demanding the discontinuation of the sanctions policy against Russia. One warning sign for Scholz's government is undoubtedly the growing popularity of the AfD, which until recently was plunged in internal disputes and was clearly lo sing support.
- The German government's decision is also linked to the deteriorating situation of companies. The competitiveness of many industrial sectors was based on the assumption that cheap gas from Russia would be available at least in the medium term. As supplies have been completely cut off and energy prices have massively increased, production is no longer profitable for some industries. The government fears that this will lead, firstly, to a wave of bankruptcies, and subsequently to an exodus of business to countries offering access to cheaper energy and thus to a creeping deindustrialisation of the German economy.
- As with the third relief package, many of the changes announced as part of the financial ‘umbrella’ have been formulated in very general terms. This applies primarily to the most important of the presented actions, i.e. the planned cap on natural gas prices for end users. The document published by the government provides only general guidelines for the mechanism – on the one hand, it is expected to protect consumers from excessive costs and, on the other hand, to include incentives to save gas (especially since gas consumption by households is still at the level of previous years). As in the case of the planned cap on electricity prices, it is still not known at what level and for what basic consumption a fixed gas rate will be set for end users. Proposals from economists (including those who are part of the expert committee) oscillate around an upper level of 10–12 cents / kWh against the expected market price of 25 cents (the long-term average price in recent years was about 6 cents). It is estimated that the costs of this instrument alone could exceed €100 billion by spring 2024. Ultimately, they will depend on a number of external factors, in particular the wholesale gas price on the stock exchange.
- The creation of the new fund enables the government coalition to cancel the controversial levy (Gasumlage). This was intended to involve German gas consumers in compensating for the losses sustained by German gas importers facing bankruptcy due to the cutting off of gas supplies from Russia. Both the very concept of burdening end users with most of the related costs (originally estimated at €34 billion) and the defective design of the mechanism have become the subject of huge controversy. This led to a

decline in the ruling parties' ratings, so the government coalition members began shifting blame onto each other for this solution (most of the blame was put on Habeck). The controversial levy was cancelled just two days before its planned implementation, which means that it will be on most October gas bills despite its cancellation (however, it will be reimbursed). The costs of offsetting the losses of importers, Uniper, SEFE (formerly Gazprom Germania) and VNG, will now be borne by the WSF. Moreover, in the face of the exacerbation of the crisis, there is speculation that the state will take over part of VNG's shares and that SEFE will be nationalised like Uniper (see '*Germany: nationalisation of Uniper*').

- The financing of the €200 billion fund was the most controversial issue in the coalition's negotiations. Finance Minister Christian Lindner of the FDP – a fiscal hawk in the coalition – is seeking to reinstate the constitutional 'debt brake' next year (it was suspended due to the pandemic) and return to financial discipline. Increasing spending is thus a politically awkward issue for Lindner. The compromise is based on the fact that the WSF will be an non-budgeted fund, filled this year due to the currently suspended debt brake and with spending not to be included into the upcoming federal budget and its fiscal rules. From the point of view of the transparency of public finances, this is a very controversial solution, although not without precedent: the German state tested it thoroughly in the pandemic crisis and by the creation of a special €100 billion fund for the Bundeswehr. However, the coalition is facing a very difficult debate about the point of continuing the fiction of a 'debt brake', since hundreds of billion euros are spent annually through a 'parallel budget'.
- The fund for intervening on the energy market will also provoke a discussion in the European Union. On the one hand, it is perceived as an adequate and necessary response to the energy crisis, but on the other hand, the WSF funds raise serious doubts from the point of view of the cohesion of the common market. The €200 billion spent on aid to German companies will improve their competitiveness against companies from other member states whose governments cannot afford a similarly generous intervention due to fiscal constraints. It raises the question about where the limits of permitted state aid are drawn. The European Commission has announced that it will issue an appropriate interpretation, but – like the previous recommendation during the pandemic – this will not be an obstacle to the implementation of the programme. Member states will be more resistant. The WSF has already been strongly criticised by Italy, which accused Germany not only of violating the rules of the common market, but also of a lack of solidarity in the face of the pan-European challenge. It should be expected that there will be increasing pressure to adopt an EU 'brake' on gas prices, which is demanded by Italy, Spain and France (among others). However, the effects may be more far-reaching. Germany's individual action to support its own consumers will provide more arguments to supporters of launching another fiscal fund in the NGEU formula, which this time will be used to stabilise the energy market and increase the independence of the EU. It will be difficult for Germany to cast doubt on the point of such a programme as it has decided to provide huge support for its own economy, without even consulting its EU partners.
- The announcement that a large fund has been created to combat the energy crisis is also important for Germany's stance on the war in Ukraine. So far this has been rather

cautious, which is reflected in even relatively modest military assistance. The title of the government document – *The Economic Protective Umbrella against the Effects of Russian Aggression* – leaves no doubt as to whom the responsibility for the current economic situation and the impoverishment of citizens is attributed, and what challenge Germany is currently facing. In particular, the Greens and the FDP stress that "we are in a state of energy war" caused by Russia, and not only the state of the economy is at stake, but also "freedom and prosperity" in Europe. The tightening of the rhetoric can be interpreted as an attempt to justify the unprecedented scale of spending, and perhaps also as an announcement of Germany's greater involvement in financial and military support for Ukraine and the strengthening of the sanctions regime.