LETTER FROM BERLIN

Energy Idiocy

By Klaus C. Engelen

This "Letter from Berlin" is written under the dark clouds of Germany's worst economic and political threats of the post-World War II era. Russian President Vladimir Putin's invasion of Ukraine has exposed Germany as Europe's largest, strongest, and most globally connected economy in its dangerous dependence on the flow of Russian gas. Russia reduced gas supplies in June for the main pipeline Nord Stream 1 to below 40 percent, before cutting them altogether on July 11 to allow for routine annual ten-day maintenance. Gas resumed flowing through the end of July and August, but it was throttled to barely 20 percent of the previous amount. And in early September, the Kremlin stopped the flow entirely in order to pressure Europe to remove sanctions on Russian oil.

Chancellor Olaf Scholz interrupted his summer vacation in Bavaria for a Berlin press conference on July 22 to assure the nation that his government would do "what is necessary and as long as it is necessary" to help keep the country functioning. He promised that there will be further relief measures on a permanent basis to protect citizens from increasing energy prices caused by Russia's war on Ukraine. "You never walk alone," Scholz said in English, repeating in a way the promise of then-Chancellor Angela Merkel at the height of the 2015 refugee crisis, *"Wir schaffen das"* (We can do it).

To meet the challenge, Scholz announced that his government would acquire 30 percent of Uniper, Germany's major gas importer, provide €7.7 billion in government support, and expand a credit line from €2 billion to €9 billion. Concerned over Russian "blackmail," the German government raised this year's required gas level for storage operators to 95 percent capacity by November 1. In early September, the level stood at 87 percent.

"As food and fuel crises start to pinch, governments will come under pressure from poorer, hungrier, colder voters. Soak up the summer rays while you can—a full-blown Russian winter is heading towards Europe," according to *Politico.* "Even as fighting continues to rage in Ukraine, the war is already making itself felt across the Continent in the form of rising food prices, fears of gas shortages, and worries about the economy. And with Russian President Vladimir Putin showing readiness to use food, fuel, and fertilizers as weapons of war against Western democracies who are arming Ukraine and sanctioning Moscow, things could get rapidly worse."

At the same time, Germany, like other Western countries, is being hit hard by the highest inflation in two decades. At 8.8 percent in August 2022, inflation was at its highest level since German reunification more than three decades ago. There is a real threat of a wage-price spiral, as prices increase as a result of higher wages.

The euro has reached parity with the dollar, falling to its lowest level in twenty years. Many experts in the nineteen European countries using the currency view this development with foreboding as Europe struggles

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with an energy crisis caused by Russia's war in Ukraine, explains the Associated Press. "A currency's exchange rate can be a verdict on economic prospects, and Europe's have been fading. Expectations that the economy would see a rebound after turning the corner from the Covid-19 pandemic are being replaced by recession predictions."

The news on the energy front in Germany is particularly alarming. As reported by *Deutsche Welle,* Klaus Müller, the head of Germany's Federal Network Agency for Electricity, Gas, Telecommunications, Post, and Railways, or *Bundesnetzagentur,* warned that "consumers may see their gas bills increase by two or three times as Germany faces the prospect of Russian supplies cut." The seriousness of the crisis becomes clearer by the day. Says Müller, "Most scenarios are not pretty and result in either too little gas at the end of winter or already—a very difficult situation—in the autumn or winter."

PROSPERITY IN DANGER

"Is the German model of prosperity in danger?" That's the question the magazine *Der Spiegel,* with a team of nine journalists, asked in a recent issue. "There is much to suggest that the crisis could also create difficulties for the middle class here. Politicians are viewing the situation with great concern because the middle class is a pillar of support for the state and democracy, with its political convictions, its commitment to work, and its desire for stability."

Looking back, *Der Spiegel* notes, "Perhaps the best comparison for the current situation is the oil price crisis of 1973. But that produced relatively minor disruptions to the global economy. This time around, several crises are coming together at the same time, with the threat of recession in many industrialized nations, led by the United States. The coronavirus pandemic, with its disruptions to supply chains. And, of course, Russia's attack on Ukraine and its devastating impact on energy prices."

Germany's traffic-light governing coalition of the SPD, Greens, and FDP, just a few months into their four-year term, are indeed confronted with what some call "a German house on fire."

On the complicated issue of heavy weapon deliveries to Ukraine, and on the escalating national and European energy crisis front, the SPD's Chancellor Scholz, critics complain, was not seen taking command in a forceful way. By contrast, Robert Habeck of the Greens, serving as vice chancellor and economics and climate minister, has dominated the media with a broadside of warnings and new emergency initiatives.

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Before introducing comprehensive gas emergency laws amid fears of a cut-off, Scholz called the heads of trade unions and top employers to the Chancellery. Representatives of the German Bundesbank and the German Council of Economic Experts also participated. Scholz wanted to "give employers financial breathing room without overburdening employers and fueling inflation risks." Although he proposed to employers that his government will offer to make tax-free special payments to their employees, he didn't get far in his concerted action initiative.

The next day, speaking before the Economic Forum of his Social Democratic Party, Scholz promised the necessary legislation to end the "fatal dependence" on Russian gas which would allow the government to bail out energy companies such as Uniper, the largest distributer of Russian gas in Germany, currently on the verge of bankruptcy. The new legislation also would allow Uniper to pass on some of the increased costs among its customers and companies.

THE CRISIS MANAGER

Habeck had to get the gas emergency plan through both chambers of the legislature as quickly as possible using a fast-track procedure while dominating the media channels on the escalating Russian gas crisis threat—in contrast to what some call the "stoic calm" of Scholz, the chancellor.

On the first day of pipeline maintenance in July, French Economy and Finance Minister Bruno Le Maire predicted, "There is a strong chance that Moscow will today halt gas supplies to Europe. Let's prepare for a total cut-off of Russian gas. Today that is the most likely option."

In the face of Putin's halt of gas supplies through Nord Stream 1 in early September, Habeck faced the "bitter reality. "It won't come back," he said in a panel with European Commission President Ursula von der Leyen.

The new legislative initiatives on the gas supply front have been supported in Germany by the Long-Distance Gas Network Operator Association (FNB Gas), the industry association. As FNB Gas explains on its website, "The current geopolitical situation poses major new challenges for the German and European gas industries. Currently, 35 percent of Germany's natural gas supply comes from Russia."

The legal basis for securing gas supply in the event of a crisis is the European regulation concerning measures to safeguard the security of gas supply. Three warning stages are provided. The early warning level was called in March of this year when major disputes arose about the Russian request to pay for gas deliveries in rubles. Habeck's economy ministry convened a crisis team consisting of authorities and energy suppliers to assess the situation and produce a report.

The alert level, the second stage of the gas emergency plan, was triggered on June 24, 2022, when Gazprom started reducing gas supplies to Germany to 40 percent of regular capacity. "Cutting gas supplies is an economic attack on us by Putin," Habeck said at a press conference. He continued: "We are in a gas crisis. Gas is a scarce commodity from now on. Prices are already high, and we have to brace for further increases."

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If the market-based tools from the first two stages of the emergency plan do not stabilize the supply situation, or if there is an exceptionally high demand for gas, significant disruption of gas supply, or other significant deterioration of the supply situation, the government can declare an emergency stage by regulation. In the process, the Federal Network Agency becomes the "federal load distributor." The state intervenes directly in gas distribution in close coordination with the network operators. So far, the German government has not yet called the emergency stage.

One of the most important questions in the escalating gas supply crisis in Germany and other EU member countries is whether the protection laws for consumers and protected customer groups can be sustained, or if so-called systemically important industry sectors will receive needed gas supplies.

PUTIN'S ENERGY TRAP

With new economic minister Habeck, "the traffic light coalition has now in a few months to correct what Merkel's governments in sixteen years did not find necessary: to find alternatives for Russian gas," concludes Moritz Koch, author of a devastating analysis in *Handelsblatt,* Germany's leading economic and financial daily, in July.

Koch's damning judgement: "German energy policy was a mixture of carelessness, stubbornness, and self-righteousness." Koch points out that when Merkel left the chancellor's office, 55 percent of Germany's gas imports came from Russia (now 35 percent). And this was true despite it being brought to her attention last fall that Russia was pursuing a policy of shrinking gas deliveries and organizing lower filling levels in the Gazprom-owned pipeline system. Merkel stuck to her decade-long mantra of confidence that Russia had always met its contractual obligations.

What Koch, *Handelsblatt*'s Brussels bureau chief, found in his many interviews with top politicians, diplomats, and civil servants is "a picture of a sleep-walking government apparatus that was gambling away Germany's energy security."

Looking only at Russia's ever-decreasing gas deliveries and filling levels for Germany and other EU countries during 2021, concludes Koch, the sign was on the wall. He recounts how Berlin diplomats and politicians were still sticking to the notion of economic and geopolitical "interdependence" between Russia and Germany as a safety net against any future military ventures. Putin's 2014 annexation of Crimea from independent Ukraine against international law—in a special operation with hybrid military back-up—did not cause Germany's political and business leaders to question the notion of "interdependence" as a state of mutual dependence and take a closer look at Germany's and Europe's real geopolitical security interests, especially in view of the energy needs.

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What makes Koch's account so memorable is how much those in Germany who were responsible—from the highest echelons of government to the bureaucracy and the captains of industry—tended to see American warnings on the gas front mainly as an American ploy to sell more higher-priced liquefied natural gas produced from fracking to Germany and other European countries.

This was obvious in how the new special energy security diplomat for the Biden administration, Amos Hochstein, was sidelined and blocked during his first Berlin visit in September of last year. His warnings about escalating gas prices and—in the view of U.S. experts—dangerously undersupplied German and EU gas markets measured by the extremely low filling levels of the Gazprom-dominated pipeline network on the Continent met with a host of counterarguments in the economics ministry.

Hochstein, who had already served as an energy security adviser in the Obama administration, was lectured by high officials in Berlin's economic ministry that the lower gas filling levels in 2021 might be explained by Moscow wanting to put pressure on Berlin to speed up the certification and opening Nord Stream 2.

Fortunately, during his second Berlin visit shortly before Putin invaded Ukraine, Hochstein was able to

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air his dire warnings to Habeck, who had entered the ministry with a big broom. Koch notes that two of the key department heads who didn't take the American energy security envoy seriously are no longer in their positions.

PREPARING FOR THE WORST

"Cold, dark, costly—the coming emergency winter and what has to change in Germany's energy policy" read *Handelsbatt's* weekend edition in mid-July. "With the threat of a stoppage of Russian gas flows, Germany is facing a dramatic winter. Enterprises and politicians are struggling frantically to avoid the worst consequences. But how can Germany secure its energy needs in the longer term?"

The bitter news that the large team of *Handelsblatt* journalists found while visiting the major industries in Germany that depend on a continuous and reliable flow of Russian gas was confirmed a few days later. As *The Economist* documented in its July 15 edition, "The high cost of low pressure. Can Deutschland AG cope with the Russian gas shock?"

Germany has most to lose in the gas crisis caused by Putin's Ukraine war, argues *The Economist,* because industry accounts for 37 percent of German gas consumption, one-third more than the EU average, and industry makes up 27 percent of Germany's GDP, compared with about 17 percent in Britain and France. The much larger share of industry has made Germany a "gas-guzzler." BASF's mega-plant in Ludwigshafen is Germany's biggest single consumer of gas. No wonder that from the start of the gas crisis Martin Brudermüller, BASF's chief executive, is making headlines with the warning that "Russian gas deliveries have been the basis for the competitiveness of our industry." Should Russia stop supplying gas to Germany, this could cause "the most severe economic crisis since the end of the second world war."

What *The Economist* found at the huge BASF production site—the need for an adequate flow to secure gas pressure at least above 50 percent—the *Handelsblatt* team experienced in many other smelting industries. At the largest German aluminum producer TRIMET in Essen, Hamburg, and Voerde, chief executive Philipp Schlüter expects "the worst in the fall." A gas halt from Russia would be "the Super-GAU." Said Schlüter, "Without aluminum, no cars can be build, we won't have enough material for electric cable, which runs through the whole value chain." All the smelting production industries which need enough gas supply to keep the heating temperatures high enough for the melting process are alarmed as never before. Paul Niederstein, managing director of the Coating Company specializing in surface finishing, explained that their 7,000-ton pot at held 450 degrees needs about a week to pump out the molten zinc so that the production site won't be damaged. The aluminum and the zinc smelters, along with other industries such as steel and glass, depend on an adequate and stable gas supply to fire extremely elevated temperatures. They don't know whether they can continue their production and keep their workers employed. ◆

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Smick Housekeeping Surprise

Working these days in Berlin sorting the mountains of papers, books, and reports accumulated over decades of reporting in Europe and the United States, I found a collection of remarks from the Institute for New Economic Thinking's 2012 Berlin conference. To my surprise, a panel moderator was David Smick, *TIE*'s founder, editor, and publisher. He opened the discussion with brief comments on "The Challenge of De-Leveraging and Overhangs of Debt: Inflation and Austerity."

The remarks ended with Smick's visionary prediction that was unbelievably accurate even though the conference took place more than a decade ago:

> *Thankfully, the world may no longer have a liquidity problem or even a solvency problem. What we clearly will have is a political problem. The great unknown unknown may well be political. Could the next Black Swan of systemic risk entail a political surprise beyond any of our imaginations?*

That was more than ten years ago. Time flies.

Another Berlin moment comes to mind. The International Monetary Fund and European Bank for Reconstruction and Development annual meeting was held in then-divided Berlin in 1988. My piece "Angst and Anger: Why the Germans Hate the World Bank and IMF" in the September/October 1988 *TIE* garnered a lot of attention when some of the thousands of bankers attending the meeting couldn't move from one hotel to another because the streets were full of violent anti-capitalist protestors.

—Klaus Engelen