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No electricity subsidy for German industry

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That’s good. Transformation must be accelerated, not slowed down

There was hardly an issue on which the German government was so divided as the proposal to help industry by reducing electricity costs. The SPD parliamentary group and the Greens were in favor. The Minister of Finance and the Chancellor opposed the idea. The decision following this week’s cabinet retreat in the baroque castle of Meseberg in Brandenburg north of Berlin was – drumroll – that power for German industry will not be subsidised.

The decision is to be welcomed. The industrial electricity cap would have been problematic due to distributional, regulatory, and climate policy considerations.

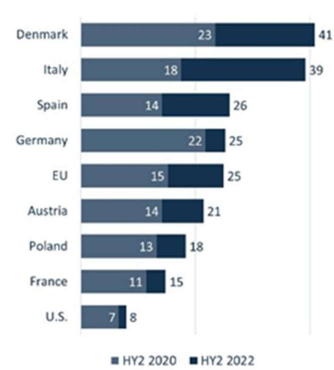
Chancellor and Minister of Finance prevail

How expensive is the electricity really?

As the figure shows, the German industrial power price is not the crass outlier in Europe it is sometimes portrayed to be. German electricity prices have indeed risen since the start of the war in Ukraine, but less than elsewhere. This is despite the fact that the last three nuclear reactors have been shut down in the meantime.

The fact that the German manufacturing sector is nevertheless particularly affected is not only due to its relative importance. At around 20%, the industrial share of GDP in Germany is significantly larger than in most other European countries (exception: Czech Republic). The industrial structure also plays a role, with a relatively high weight of energy-intensive industries such as chemicals and metals. In these sectors, production has already shrunk by almost a fifth since the beginning of 2022.

Industrial electricity prices in comparison (cents/kWh)



Source: Eurostat, consumption 500MWh to 2000MWh, USA: EIA

The subsidy would create more problems than it solves

In terms of regulatory policy, subsidies must be viewed critically as interventions in the market mechanism. Prices have a central function in the market economy. They are intended to indicate scarcity and influence behavior accordingly. When the government overrides price signals, inefficient outcomes result. Overall economic prosperity suffers because there is no apparent market failure that would have to be corrected by subsidies.

Market price mechanism ensures efficiency

It is argued that the subsidy to the industry builds a bridge to the time when the development of renewable energies will have progressed so far that power prices will settle at a low level. But who can say with confidence how long this bridge must be? Or whether the competitiveness of energy-intensive companies would be secured at all in such a brave (re)new(able) world? Not to mention the doubtful admissibility under EU state aid law.

Electricity subsidy would reduce pace of transformation

Presumably, the subsidy would have been financed from the more than €200 billion Climate and Transformation Fund. A bizarre situation would arise in terms of climate policy: The federal government would make electricity – generated to a significant extent (2022: 33%) from coal – cheaper for established energy-intensive industries. This would be at the expense of innovative technologies of the future, for which less money would remain in the treasure chest. Necessary structural adjustment processes towards climate neutrality would be hindered that way, not promoted.

Medium-sized companies have other worries

The industrial electricity subsidy would presumably benefit mainly larger corporations. However, medium-sized family businesses have other problems to contend with, such as bureaucracy and a shortage of skilled workers (see To-the-Point! here). The distributional effects of an industrial electricity cap between companies would have been problematic. It is to be hoped that the dispute over the electricity subsidy is now off the table for good.