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## Business

## Germany's high electricity prices

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Apr 23rd 2009 | BERLIN

From *The Economist* print edition

## Change is slowly coming to Germany's dysfunctional electricity market



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HEARTENING though it may have been to shareholders in RWE, the rosy earnings forecast released on April 22nd by Germany's second-largest electricity firm was unfortunately timed. RWE's prediction that profits would only go up over the next few years, recession be damned, comes just days after Germany's federal cartel office said it had started an investigation into electricity producers, including RWE, and the wholesale electricity market.

The competition regulator is trying to work out why energy prices in Europe's biggest economy are so stubbornly high, and in some cases still rising, even though oil and gas prices have fallen sharply. It suspects that generators may have been keeping prices artificially high by, for instance, shutting power stations in concert to limit supplies. Finding evidence of that sort of skulduggery may be difficult, and proving it even more so. But regulators need not look too hard to see that Germany's electricity market is broken and that a flawed liberalisation of the market over the past decade seems only to have entrenched many of its problems.

The first sign that the market is not working is in Germany's electricity prices, which are among the highest in Europe, even though it has access to abundant cheap coal. Moreover, Germany's electricity prices have remained persistently high even at times when they would have been expected to fall. Analysts at Credit Suisse, an investment bank, reckon the slowing economy will reduce electricity demand by about 5%. Coal prices have dropped by half from last year. Yet there is little sign that either falling demand or lower input costs are leading to cheaper electricity. Wulf Bernotat, the boss of E.ON, Germany's biggest electricity firm, said this month that he did not expect German consumer prices for electricity to fall this year.

The main reason Germany's electricity market is not working as it should is the lack of competition. The four biggest utilities in Germany generate more than 80% of its electricity; the top two, E.ON and RWE, more than 60%. Liberalisation has, if anything, exacerbated this. Germany had eight big electricity producers in 1997,



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before the government liberalised the market, but the number has since fallen by half because of mergers and takeovers, says Uwe Leprich of the Hochschule für Technik und Wirtschaft in Saarbrücken.

A second problem is that Germany's biggest electricity generators also own the networks that distribute electricity. Critics argue that this gives them a huge advantage over independent producers, which may struggle to gain access to the networks fairly or, if they do, gain as much information on supply and demand across the grid. The European Commission has long criticised this "vertical integration" but it has had little success in getting its members to agree to force firms to "unbundle" generation and transmission.

Change is, however, coming on two fronts. The first is that antitrust regulators in Germany seem to have woken up to the fact that the country's electricity market is not competitive. And the European Commission is having some success in forcing firms to "unbundle" using antitrust powers. Late last year it closed an investigation into alleged price manipulation by E.ON after the utility agreed to sell its long-distance distribution network along with some of its generating stations.

And over the longer run, ambitious plans to increase the share of electricity from renewable sources may erode the dominance of the country's four biggest electricity generators. Germany hopes to get as much as 30% of its electricity from renewable sources by 2020, and although few in the industry think the target will be met, there is nevertheless likely to be a huge investment in new generating capacity over the coming decades. Judicious action by antitrust authorities now could ensure that it adds to competition in the electricity market rather than simply entrenching the incumbents' positions. But because of the high cost of renewable energy, even with more competition in the market, Germany's power prices are likely to keep on rising.

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