

PRESS RELEASE

Special report: Setting Out for a New Climate Policy

Wiesbaden, 12 July 2019 – The German Council of Economic Experts presents its special report "Setting Out for a New Climate Policy" to the German Government today, in which it discusses reform options for climate policy in Germany.

The German Government currently has the great opportunity for initiating a reorientation of climate policy that combines effectiveness and economic efficiency, and at the same time is internationally compatible. The core element of this new strategy should be to employ a CO₂ price as the central instrument of climate policy. *"The current debate offers a historic opportunity to change Germany's fragmented, expensive and inefficient climate policy in such a way that the pricing of CO₂ takes centre stage,"* says Christoph M. Schmidt, Chairman of the German Council of Economic Experts.

Global Coordination. A globally coordinated approach is essential to mitigating climate change. Germany can contribute to this by acting as a role model and showing that the agreed climate policy goals can be achieved in an economically efficient manner and without major social distortions. Striving for further national or even sectoral targets beyond those agreed at European level would not be sensible, though. Germany should rather use its willingness to make even greater efforts as a lever in European and global climate policy negotiations to gather the commitment of other states to more ambitious coordinated goals.

Integrated emissions trading. By 2030 at the latest, the European emissions trading system (EU ETS) should be extended to the transport and building sectors in all member states. This will effectively establish a uniform CO₂ price across all sectors. At the European level, pursuing separate sectoral targets would then be obsolete; any additional national climate targets should already be dropped immediately.

Transitional solution. The path to this integrated system must be initiated immediately by establishing a separate CO₂ price in the transport and buildings sectors not yet covered by the EU ETS. This must be set up as a transitional solution and must be terminated at the time of integration into the EU ETS. Two approaches are available for implementing this transitional solution: a separate emissions trading system or a CO₂ tax. For either approach its success primarily depends on the political will to establish the CO₂ price as the core instrument of climate policy.

Separate emissions trading. Separate emissions trading for the non-EU ETS area is easier to communicate and will be easier to transfer to the integrated EU ETS. However, its implementation will take some time. The political challenge is to immediately initiate its setup to credibly signal that this choice is not a covert delaying tactic. In addition, market participants need to be convinced by policy makers of the long-term binding nature of the quantitative restriction.

CO₂ tax. A CO₂ tax could be quickly introduced in non-EU ETS sectors on the basis of existing energy taxation. This, however, is not simply a question of setting an initial CO₂ tax and adhering to a predetermined path of tax increases in years to come. Rather, since the avoidance costs and demand elasticities in the transport and buildings sectors are yet unknown, the tax must be adjusted regularly. To achieve the binding climate policy targets policymakers must have the courage to mandate large tax increases if necessary. It makes sense to initially orientate the price path on the current price in the EU ETS and to start with a value between 25 and 50 euros. But the lower the entry, the sharper the future tax increases will have to be. Moreover, a CO₂ tax will probably only be accepted by the population if it can be ruled out that it will be misused for purposes other than climate policy.

Competitiveness. In view of the high abatement costs in the buildings and transport sectors, the expansion of the EU ETS might lead to a price increase. So far, free allocation of allowances has prevented companies from being disadvantaged in international competition. If this carbon leakage protection is not sufficient, implementing border adjustments could be considered. However, this mechanism carries potential for conflict in trade policy.

Accompanying measures. To successfully achieve the EU climate targets, targeted accompanying measures, such as promoting the purchase of low-emission equipment and infrastructure investments, are required to facilitate behavioural adjustments and thus limit the necessary CO₂ price. In addition, the tax system could be revised to increase incentives to reduce CO₂ emissions.

Redistribution of revenue. The exclusive aim of CO₂ pricing in Germany should be to reduce emissions efficiently and not to generate additional tax revenues. In order to be accepted by the population, government revenues should be redistributed. This can e.g. be achieved by a lump-sum return per inhabitant or a reduction of the electricity tax.

Prof. Dr. Ottmar Edenhofer and the Mercator Research Institute on Global Commons and Climate Change with their expertise on "Options for a CO₂ price reform", and Prof. em. Dr. Ulrich Büdenbender (TU Dresden) with his expertise "Legal framework conditions for CO₂ pricing in the Federal Republic of Germany" provided significant contributions to this special GCEE report.

The German Council of Economic Experts is an independent academic body advising German policymakers on questions of economic policy. It was founded in 1963, and currently consists of five members: Prof. Dr Christoph M. Schmidt, Prof. Dr Dr h.c. Lars P. Feld, Prof. Dr Isabel Schnabel, Prof. Dr Achim Truger and Prof. Volker Wieland, Ph.D. The aim of its expert opinion published in the form of an Annual Economic Report is to help form the opinions of all authorities responsible for economic policy as well as the general public.

Further information on the German Council of Economic Experts and its publications are available at: www.sachverstaendigenrat-wirtschaft.de or follow us on Twitter [@svr-wirtschaft](https://twitter.com/svr-wirtschaft).

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