CENTRO STUDI SUL FEDERALISMO

comments
no. 182 – 22 June 2020

CARBON PRICING IN GERMANY AND THE EU'S NEW OWN RESOURCES

*Alberto Majocchi **

On 29 November 2019, the two Houses of the German Parliament approved a decision to introduce a carbon price of €10 per tCO_2 for the transport and domestic heating sector, which together account for 32% of greenhouse gas emissions in Germany. However, under pressure from the Green Party during the negotiations between the *Bundestag* and the *Bundesrat,* this price was raised from €10 to €25 per tCO_2 as of 2021, which entails an increase in the final price of 7 cents per litre on petrol, 8 cents on diesel and fuel oil, and 0.5 cents per kWh of energy. Under this mechanism, companies selling fossil fuels will be required to purchase emission trading rights, the price of which will rise gradually from €25 per tCO_2 in 2021 to €55 by 2025. Subsequently, as of 2026, the price will be determined by the market, although it cannot deviate from a price corridor set between €55 and €65 per tCO_2. In any case, the government may introduce corrective measures to ensure companies remain competitive and avoid the risks of carbon leakage. This new revenue will be earmarked to decrease the surcharge imposed by the EEG (*Erneuerbare-Energien-Gesetz*) levied on electricity bills, and to finance the development of renewable energy.

The German emissions allowance system for transport and domestic heating (methane emissions in intensive livestock farming still remain excluded) will develop in parallel with the EU Emissions Trading System (ETS) and cover most non-ETS greenhouse gas emissions. The price will be imposed on the transport sector (excluding air transport) and domestic heating, and will be levied on fuels such as petrol, diesel, natural gas and coal. It will not be paid directly by the carbon emitters, but rather by the companies that sell to end users, or by refiners (upstream approach).

The "Political Guidelines 2019-2024", presented on 16 July 2019 to the European Parliament by the then EP Presidential candidate Ursula von der Leyen, already contained a proposal "to extend the Emissions Trading System to the maritime sector and reduce the free allowances allocated to airlines over time. I will also propose to extend further to cover traffic and construction." Germany's decision is a step in this direction, and enables the controversial choice to be avoided between adopting a system where emission levels are fixed *ex ante*, and the imposition of a carbon pricing system where emission levels depend on the elasticity in demand for fossil fuels. In fact, a mechanism similar to the EU ETS is being adopted in Germany: emission permits are distributed that will be auctioned as of 2026, setting a corridor within which the price may fluctuate.

These permits would have to be acquired by those who market fossil fuels, and their relative cost would then be passed on – if market conditions allow for forward shifting – to the sale price for end consumers. Ultimately, by adopting this upstream approach, the instrument chosen is similar to the introduction of an excise duty such as the carbon tax, but has the advantage of being part of an existing mechanism, such as the ETS. As such, Germany's decision is a catalyst for the introduction of carbon pricing at the European level, which will also cover non-ETS sectors. This has been done with a view to putting forward a proposal, which the Commission has undertaken to present by 2024, to have new own resources allocated to finance the European budget, thus ensuring not only the payment of interest on funds raised on the market, and intended to finance the Next Generation EU, but also the repayment of securities issued by the Commission as of 2028.

As things stand, the introduction of new own resources – provided for in the 27 May Commission Communication presenting the Recovery Plan – and in particular both a corporation tax with a tax base determined according to common principles, and a web tax, must necessarily go through the procedure provided for in Article 311 TFEU, with the unanimous approval of the Council and ratification by the 27 member countries. Only the Border Carbon Adjustment (BCA) can be introduced under the ordinary legislative procedure; on the basis of Article 3(e) TFEU the Union has exclusive competence in the field of common commercial policy, and Article 207 (2) explicitly states that "the European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy." Moreover, because this is a customs law, the BCA is considered an own resource directly allocated to the Union budget.

However, there is also some important news regarding the Commission's proposed introduction of new resources; as Commissioner Gentiloni has often said, the Commission would carefully examine the possibility of using Article 116 TFEU as a legal basis. According to this article: "Where the Commission finds that a difference between the provisions laid down by law, regulation or administrative action in Member States is distorting the conditions of competition in the internal market and that the resultant distortion needs to be eliminated, it shall consult the Member States concerned. If such consultation does not result in an agreement eliminating the distortion in question, the European, Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall issue the necessary directives. Any other appropriate measures provided for in the Treaties may be adopted."

If this hypothesis were to be shown to be viable, achieving the objective of introducing new own resources would become a more concrete possibility. This would enable the EU to begin to truly undertake its ecological transition, by introducing carbon pricing at the European level which does not distort competition due to the different treatment of carbon dioxide emissions in the member countries. It would also help the EU come up with the new own resources proposed by the Commission and earmarked to finance the European budget. This is a decisive step forward for the creation of a fiscal union, which is the second pillar – alongside monetary union – of a federal Union.

* *Professor Emeritus of Public Finance at the University of Pavia and Vice President of the Centro Studi sul Federalismo (his new book Carbon pricing was published on 11 June 2020 by* il Mulino, *Bologna)*

(The opinions expressed here do not necessarily represent the CSF)