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Is Germany Becoming the European Pollution Haven? (with E. Rottner and P. Richter)

We Relative prices determine competitiveness of different countries. We investigate the impact of diverging developments in implicit carbon prices – a measure comprising carbon and energy prices, as well as command-and-control measures – between Germany and other EU countries on CO₂ emissions from manufacturing. We quantify a trade and environment model, using data on aggregate output, trade, and emissions, with model parameters estimated from the German Manufacturing Census. Our model recovers the evolution of implicit carbon prices in Germany, the rest of the EU, and the rest of the world. From 2005 to 2019, implicit carbon prices declined across most manufacturing sectors in both Germany and other EU countries, with a more pronounced decrease in Germany. Our counterfactual analyses suggest that this intra-EU divergence has substantially increased German industrial emissions. Had the rest of the EU experienced the same path in implicit carbon prices as Germany, German emissions would have been notably lower. In this regard, Germany has increasingly emerged as the European pollution haven. We discuss the efficiency of reallocating emissions within Europe in the context of emissions trading and overlapping industrial policy.