Carbon Pricing in the EU Green Deal / Fit for 55

Question:

What are the carbon pricing changes in the EU Green Deal / Fit for 55?

Answer:

The context for the EU Green Deal is established by the EU Climate Law which establishes two key goals: a legal objective for NetZero (climate neutrality) by 2050; and a 55% reduction of GHG emissions by 2030. This 55% reduction is more ambitious than previous goals and explains the naming of Fit for 55, a package of legislation.

For the EU, carbon pricing has already been a cornerstone policy in the strategy on climate change and is implemented by the Emissions Trading System (ETS). The ETS is cap and trade system[1], it creates a fluctuating carbon price[2] based on a market of allowances to pollute. Currently allowances are required by power generators and major industries only; this covers roughly 40% of EU emissions. There are several other policies which establish environmental goals which overlap to support and reinforce the goals.

The EU Green Deal contains 130 pieces of legislation[3], these include updates to existing policies and new policies. They can be characterised as follows:

- Increasing the price and coverage of carbon pricing,
- Increasing related environmental goals,
- Enhancing other environmental goals.

This summary focuses on the first specifically in relation to impact on citizens and touches on the second.

To achieve the more ambitious goals, the EU is reducing the cap in the current ETS more rapidly than legislated before. In addition, it is extending coverage to include elements of maritime, aviation and (most significantly for citizens) buildings and road transport. The buildings and road transport will be implemented as a new, separate ETS using an upstream price for wholesalers. Called ETS BRT or ETS II, it is scheduled for introduction in 2027 or 2028. Member States (MS) have the option to implement a national Carbon Tax that would satisfy the requirements (a price of ≈€45) and delay a national ETS II till 2030.

Historically, the issue of carbon leakage has been addressed by giving free ETS allowances ('rights to pollute') to energy-intensive sectors exposed to international trade. The EU is now changing the tools to address carbon leakage by introducing a Carbon Border Adjustment Mechanism (CBAM). The CBAM will apply to appropriate EU imports and price consumption-based emissions. It further enhances

[1] The reason the EU uses a cap and trade system rather than direct taxation for price setting is related to the fact that the current treaties require unanimity for tax, politically tax is a risky path most politicians do not want to rely on. Tax was originally considered before introduction of the ETS. The war in Ukraine and the related energy crisis are contributing to the EU reviewing "unanimity" (https://www.elysee.fr/en/emmanuel-macron/2023/01/22/french-german-declaration).

[2] https://tradingeconomics.com/commodity/carbon

[3] https://www.europarl.europa.eu/legislative-train/theme-a-european-green-deal

carbon pricing by enabling the phase out of free allowances from 2027 to 2034. CBAM enhances EU diplomacy and trade pressure towards international climate action. There is an EU obligation to assess whether further legislation is required to protect against leakage associated with EU exports.

The existing ETS allows for 40-60% of revenue (from major industries) to be directly rebated to citizens. There are no known Member States (MS) acting explicitly on this, though there are studies, e.g., for Slovakia[4].The ETS II links carbon pricing to household finances more directly than previously and will be accompanied by a Social Climate Fund (SCF). The SCF is funded by revenue from the ETS II and distributed to MSs to be rebated to vulnerable households. The EU sees the SCF as a short-term protection funded for 7 years, presumably based on the expectation that MS's other policies, for example on insulation, public transport, and energy efficiency, will remove the need for such protection. There is also an estimated limit of 35% of ETS II revenue that each MS is permitted to use for rebating to citizens. Because the spread of those in energy poverty is unequal across the EU, the SCF involves some redistribution of revenue between MS which further complicates the associated politics.

Key points:

- Carbon pricing gets stronger as a key policy tool within the EU Green Deal.
- The price for the ETS (major industry ≈40%) is set to rise.
- Additional coverage will be added buildings and road transport (+ air and maritime).
- CBAM will introduce pricing for imports and phase out of "free allowances".
- There will be a fund to support the most vulnerable households with cash transfers.
- Member States will have the option to implement national carbon pricing.

Key links:

- EU Climate Law: https://climate.ec.europa.eu/eu-action/european-green-deal/european-climate-law_en
- EU Green Deal legislative train schedule: https://www.europarl.europa.eu/legislative-train/theme-a-european-green-deal
- Draft agreement on ETS: https://data.consilium.europa.eu/doc/document/ST-6210-2023-INIT/en/pdf

[4] https://d3n8a8pro7vhmx.cloudfront.net/progressiveslovakia/pages/371/attachments/original/1637749231/Progresívne_Slovensko_-_Climate_dividend.pdf