CENTRE FOR ECONOMIC POLICY RESEARCH

CEPR CLIMATE CHANGE

CEPR/EAERE Webinar on Climate Policy: The European Green Deal

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On July 14, 2021 the European Commission presented its "Fit for 55" Proposal. Stefanie Hiesinger, Member of Cabinet of the Executive Vice-President for the European Green Deal, Frans Timmermans at the European Commission, introduced us to the key insights of this proposal, followed by a discussion on his perspective by Peter Liese, Member of the European Parliament, and a commentary by Artur Runge-Metzger, Director for Climate Strategy, Governance, Emissions from Non-Trading Sectors at the European Commission Directorate General for Climate Action. Finally, Ottmar Edenhofer, Director of the Potsdam-Institute for Climate Impact Research (PIK), shared his views on the whole economy carbon price for Europe and how this goal can be reached. The event was moderated by Brigitte Knopf, Secretary General of the Mercator Research Institute on Global Commons and Climate Change (MCC).

Main Presenter

Stefanie Hiesinger
European Commission

Commentary & Insights

Peter Liese
European Parliament

Artur Runge-Metzger
European Commission

Ottmar Edenhofer
Potsdam Institute for Climate Impact Research and CEPR

Moderator

Brigitte Knopf
Mercator Research Institute on Global Commons and Climate Change

Key Points of the Webinar

The European Green Deal: an ambitious and comprehensive package

The EU is pursuing an ambitious climate target, aiming to reach carbon neutrality for Europe as a whole by 2050, and reduce greenhouse gas (GHGs) emissions by at least 55% by 2030, compared to 1990 levels. The "Fit for 55" package is designed to translate these ambitions into climate action. It builds on existing frameworks as well as what could be called the "Fit for 40" package, which was agreed upon in 2014 and was designed to deliver a 40% reduction of emissions. The "Fit for 55" package presses fast forward on the targets and actions enshrined in the previous package, while also developing new instruments leading toward -55%. It covers a wide range of areas and sectors.

- ### The Emission Trading System (ETS): the corner stone of the EU Climate Policy

    - #### Evolution of the current ETS and creation of a second market of emissions permit

The current European ETS scheme, which currently covers emissions from the power sectors and industries, will be strengthened through the lowering of the cap, which would deliver a strong price signal. Furthermore, the system will be extended to include maritime sector emissions. Regarding aviation, which is already covered by the ETS, free allowances will be phased out, while the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) will be implemented.

Furthermore, at the core of the "Fit for 55" package is the creation of a second market of emissions permit, the ETS2, that will cover road transport and buildings from 2026 onwards. Part of the emissions of buildings are already subject to the price signal of the existing system, namely the power sector and electricity used by households. Heating fuels will thus be added, meaning that fuel suppliers will have to surrender ETS allowances and cover the emissions coming from fuel use. Similarly, regarding road transport, refineries will have to surrender the allowances for the emissions from the use of the road transport fuels. The concerned companies will then pass on the cost to consumers.

The creation of a second, separated ETS is notably justified by the marginal abatement cost curves question. The marginal abatement cost is indeed much lower for the power and industry sectors than for heating and transport. Having two different prices and systems converging within, say, 10 years will thus permit a smooth transition. Furthermore, the two ETS differ in terms of design: the first is a *downstream system*, with direct regulation on the installation operations or ship owners, for instance, while the second is an *upstream system* directed at fuel suppliers and not at households or car users.

In terms of the design of the system, it will start with increased auctioned volumes. In the first-year auction, at 30% more volume than the cap, an increased supply will also have an impact on the price. Furthermore, the market stability reserve will also operate with an initial endowment of 600 million allowances, and a threshold will be set accordingly, and operations of the reserve will be organised like the current ETS. Finally, in the case of excessive prices or price spikes, the Commission will be able to inject allowances into the system. These different features will all lead to a smooth start of the second ETS in terms of prices and market build up. Price corridors, on the other hand, are not currently an option on the table.

- **A cost-effective instrument considering social justice**

The package further addresses the fact that ETS2 will generate a transfer of price increase to consumers. In that regard, a Social Climate Fund (SCF) will be created to support the most vulnerable households. Financed by 25% of the revenue of the ETS, it will consist of 72.2 billion euros available for the period of 2025-2032. It will begin operating a year before the setup of the ETS2 to support investments and mitigate cost increase. Taking the example of the building sector, the SCF could both provide direct income – going to the renter to pay his bills – and investment income – going to the landlord for building renovation, thus addressing the issue of the price being passed on for both. The integration of the funds participates, therefore, to the setup of a fair climate policy, not only designed in terms of economic efficiency, but also addressing the question of social justice. At the member states level, national action further needs to be put in place to complement these policies and help companies and people reduce their emissions. In that regard, investment in innovation will play a key role in the coming decades, as well as regulations that can gradually introduce new technologies and provide certainty to companies who invest in innovation.

In terms of efficiency, the creation of the ETS2 is supported by the important emissions reductions generated by the current ETS in the power and industry sectors, which has not been the case through performance standards and bans. The carbon price further generates revenue to compensate important redistribution issues.

• A comprehensive policy architecture

The main building blocks of the plan includes the following:

- **The Effort Sharing Regulation (ESR):** The ESR, which sets a target for each member state in terms of GHGs emissions in sectors that are not covered by the ETS, is also revised to match the EU climate goals. National targets will increase by around 10 percentage points in the new regulation, which should deliver accountability by member states to deliver the overall targets. On the other hand, the current scope of the regulation will remain and will only be adjusted for the maritime sector.

- **Land use, land use change, and forestry (LULUCF) regulation:** The LULUCF requires each member state to ensure that emissions are compensated by at least an equivalent number of removals in the land use, land use change and forestry. This regulation will be upgraded under the "Fit for 55" to respond to the need to enhance the carbon sink – or the capacity of land and forests to remove CO_2 from the atmosphere – and halt biodiversity loss. A three steps approach is prescribed: First, no important regulation evolution will take place before 2025; secondly, between 2026 and 2030 a removal target of 3 Mt will be set, corresponding to 50 to 60 Mt more than what is being removed at the present point in time; finally, climate neutrality in the combined land use, forestry, and agriculture sectors shall be reached by 2035 at the EU level. Both the fairly early announcement and the 2035 neutrality target will allow the sector, in which changes take time to implement, to plan and adapt to these objectives. The targets will be distributed between member states that shall use policy instruments to provide direct incentive to farmers and foresters.

- **Energy Directives:** The share of renewable energy will increase to 40% (compared to 30% previously), a binding target on the EU level. Furthermore, safeguards for sustainable bioenergy from forest biomass will be strengthened, while barriers to the deployment of renewable energy will be removed. Regarding the energy efficiency directive, the target will be increased to 36% for primary energy consumption and 39% for final energy consumption at the EU level, from the current 32,5%, while further measures for key sectors will be put in place. Finally, the revision of the Energy Taxation Directive will ensure the alignment of the tax rates with the Green Deal Objectives, as well as the removal of exemptions that incentivize fossil fuels use and the promotion of sustainable fuels.

- **CO2 Emission standards for cars and vans:** The proposed regulation tightens the objectives and increases the CO_2 emission targets to reach 0 emissions by 2035. This means that new cars and vans produced from this date should be zero-emissions vehicles.

- **Fuels:** Further parts of the package are related to alternative fuels. In the aviation sector, the Refuel EU Aviation Initiative will enforce the use of blended, sustainable aviation fuels with alternative fuels in increasing percentages. In the maritime sector, the uptake and the supply of alternatives fuels will be strengthened through carbon intensity standards for the fuels used on board. Finally, the Alternatives Fuels Infrastructure regulation will ensure an appropriate deployment of infrastructure for charging electric vehicles.

- **Carbon Boarder Adjustment Mechanism (CBAM):** This scheme is meant to address the risk of carbon leakage through the setup of a carbon price on imported goods in selected sectors. It aims to avoid the EU climate action being undermined by the reallocation of production or by imports of products with higher footprints.

The Fit-for-55 must be considered as a complete set of policies that only holistically lead to the binding target of -55% emission reduction. One block can only be removed if an alternative is put in place.

However, alternatives remain unsatisfying: for instance, replacing the ETS for road transport and buildings with more regulation and taxations, with no means of redistributing the effort amongst society, will overall have a higher cost for society. The global coherence of this set of climate policies is a complex issue.