

Review of the EU ETS

'Fit for 55' package

OVERVIEW

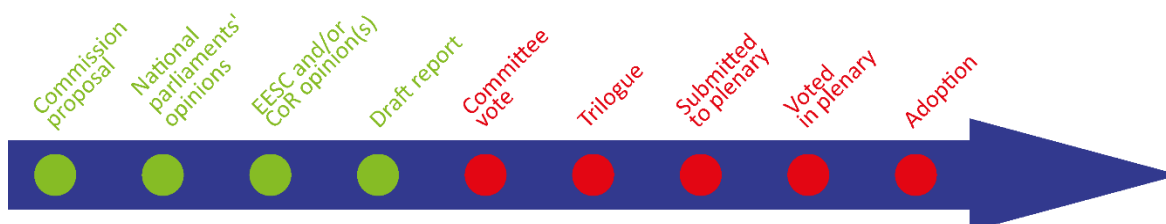
As part of the 'Fit for 55' package, the Commission presented a legislative proposal to review the EU Emissions Trading System (ETS). The aim of the review is to align the EU ETS Directive with the EU target set out in the European Climate Law to reduce net greenhouse gas (GHG) emissions by 55 % by 2030, compared to 1990 levels.

To this end, the amount of emission allowances would be reduced, fewer allowances would be allocated for free, and the ETS would be extended to maritime transport. This would reduce emissions in the ETS sectors by 61 % by 2030, compared to 2005. A separate new emissions trading system would be established for fuel distribution for road transport and buildings. The Innovation Fund and the Modernisation Fund would be enlarged, and Member States would be obliged to spend all of their ETS revenues on climate action.

In the European Parliament, the proposal has been referred to the Committee on Environment, Public Health and Food Safety (ENVI), which has appointed Peter Liese (EPP, Germany) as rapporteur.

Proposal for a directive amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757

<i>Committee responsible:</i>	Environment, Public Health and Food Safety (ENVI)	COM(2021) 551 14.7.2021
<i>Rapporteur:</i>	Peter Liese (EPP, Germany)	2021/0211(COD)
<i>Shadow rapporteurs:</i>	Jytte Guteland (S&D, Sweden) Emma Wiesner (Renew, Sweden) Michael Bloss (Greens/EFA, Germany) Danilo Oscar Lancini (ID, Italy) Alexandr Vondra (ECR, Czechia) Silvia Modig (The Left, Finland)	Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')
<i>Next steps expected:</i>	Vote on draft report in committee	



Introduction

On 14 July 2021, as part of the ['Fit for 55' package](#), the Commission presented a legislative proposal to review the EU ETS. The review aims to align the ETS with the EU target set in the [European Climate Law](#) to reduce net GHG emissions by 55 % by 2030, compared to 1990 levels.¹ It is complemented by a review of the two other main elements of EU climate legislation, the [Effort Sharing Regulation](#) (EU) 2018/842 and the [Land Use, Land-use Change and Forestry Regulation](#) (EU) 2018/841, as well as other energy and climate legislation.

Carbon pricing

A [price on GHG emissions](#) is an incentive for economic actors to reduce their emissions and invest in low-carbon technologies. It puts a price on [externalities](#), i.e. costs on others or damages, which are not reflected in the prices of goods and services. The [social cost of carbon](#) is an estimate of the economic costs of emitting one tonne of CO₂ into the atmosphere, and thus the benefits of reducing emissions. In the United States, a social cost of carbon of US\$51 is [used](#) for policy-making. Companies and institutional investors use fictional [shadow carbon prices](#) in their investment decisions to account for externalities and assess business risks related to carbon pricing.

There are two principal approaches for putting a price on GHG emissions:

- a **carbon tax**, which fixes the price of emissions and lets economic actors decide about the quantities;
- **emissions trading** (cap and trade) systems, in which the maximal quantity of emissions (the cap) is fixed and the price for emission is set by the market.

In principle, trading of emissions should lead to cost-effective emission reductions, because companies will invest in low-carbon technologies that reduce emissions as long as the price is lower than the market price for emissions. However, regulations to reduce GHG emissions induce an implicit carbon price, i.e. the cost of complying with the regulations, which may exceed the market price.

[Carbon leakage](#) occurs if companies transfer their production to other countries with no or less stringent climate regulation to avoid costs related to a carbon price. As a result, global emissions would increase. This issue can be addressed by lowering the carbon price for producers that are confronted with foreign competitors who face lower carbon costs, through [trade policy](#), or by introducing a [carbon border adjustment](#) for imports.

In 2021, there were 24 [emissions trading systems](#) in operation worldwide, covering 16 % of global emissions. Another 22 governments are developing or considering an emissions trading system.

Article 6 of the Paris Agreement provides for international cooperation, such as linking emissions trading systems, and for international carbon markets, where credits for emission reductions can be traded between countries. In November 2021, the COP26 conference adopted the rulebook for Article 6, enabling the establishment of international carbon markets.

In 2016, the International Civil Aviation Organization decided to establish a [global market-based measure](#) in the form of the Carbon Offsetting and Reduction Scheme for International Aviation ([CORSIA](#)). To compensate for international civil aviation's CO₂ emissions above 2020 levels and achieve carbon-neutral growth, emitters (i.e. airlines) would buy emissions units (representing 1 tonne of CO₂) from green projects. After a voluntary pilot phase (2021-2023) and first phase (2024-2026), participation will become mandatory for all signatory states (except certain developing countries) in phase II (as of 2027). Eighty-eight states, including all EU Member States, have been participating in CORSIA from its outset.

Brief history of the EU ETS

The EU ETS started in 2005 with a 3-year pilot phase, and phase 2 (2008-2012) coincided with the first commitment period of the [Kyoto Protocol](#). The ETS has covered aviation since January 2012.

Phase 3 (2013-2020) broadened the scope of the ETS to more sectors and gases, introduced a single EU-wide cap, made auctioning the default method for distributing allowances, and harmonised the rules for free allocation. By 2020, [emissions](#) covered by the ETS decreased by 41 % compared to 2005, a significant over-achievement of the 2020 target of a 21 % reduction under phase 3 of the EU ETS.

The 2007-2012 financial crisis depressed the demand for emission allowances, while the supply remained fixed and was further expanded through international carbon credits. This surplus caused a collapse in the price for European emission allowances (EUA) from €30 in 2008 to €2.75 in April 2013. To reduce the surplus and align the supply of allowances with the demand, a market stability reserve (MSR) started operating in January 2019.

Phase 4 of the EU ETS started in 2021, with a cap that is aligned with the previous 2030 target to reduce EU GHG emissions by 40 %, compared to 1990 levels. The legislative proposal in the 'Fit for 55' package to review the ETS aims to align emissions trading in phase 4 with the 2030 target set in the European Climate Law, of reducing net emissions by 55 %, by lowering the cap, including further sectors and improving the functioning of the ETS.

From January to December 2021, the EUA price more than doubled, from €34 to above €80. A [report](#) by the European Securities and Markets Authority finds that the market functions as expected: non-financial entities

buy [EUA futures](#) to hedge their carbon price exposure, while financial entities, acting as intermediaries, facilitate trading and provide market liquidity.

Switzerland's emissions trading system has been [linked](#) to the EU ETS since 1 January 2020. The United Kingdom stopped participating in the EU ETS with the end of its EU membership, and established its own [emissions trading scheme](#). A recent [discussion paper](#) by the City of London Corporation points to the close similarities between the EU and UK emissions trading systems and highlights the potential benefits of closer cooperation between the two systems.

Existing situation

[Directive 2003/87/EC](#) established the EU ETS, a 'cap-and-trade' policy tool for reducing GHG emissions in a cost-effective way. The system operates in all EU Member States, as well as Iceland, Liechtenstein and Norway, regulating around 10 000 installations, including power plants and energy-intensive industrial installations, and covering over 40 % of the EU's GHG emissions. Since 2012, the system also regulates aircraft operating within and between these countries.

The EU ETS is a market-based mechanism, which sets a fixed upper limit for GHG emissions (the 'cap'), which is divided into emissions allowances, each giving permission to emit one tonne of CO₂ or CO₂-equivalent² (CO₂e). The emissions allowances are partly auctioned and partly distributed for free to industries at risk of carbon leakage; the allowances can subsequently be traded between the installations.

Each Member State must ensure that, by 30 April every year, each regulated installation surrenders a sufficient number of allowances to balance its total emissions from the preceding year. Any unused allowances remain valid and can be used in subsequent years, while the total cap decreases every year to provide an incentive to reduce emissions.

Figure 1: Price of EU allowances (futures, €/t CO₂e)



Source: [Ember carbon price viewer](#).

The ETS Directive was last [amended](#) in 2018 by [Directive \(EU\) 2018/410](#), which set the parameters for phase 4 of the EU ETS (2021-2030). The ETS contributes to the EU's previous [2030 target](#) of reducing GHG emissions by 40 % compared to 1990 levels, by reducing emissions in the ETS Directive sectors by 43 % compared to 2005 levels. To this end, the annual linear reduction factor for GHG emissions increased from 1.74 % to 2.2 %. From 2021 onwards, 57 % of allowances are auctioned.

Market stability reserve

[Decision \(EU\) 2015/1814](#) established the [market stability reserve](#), which started to operate in January 2019 as a response to the over-supply of allowances since 2009, a result of the economic crisis and high imports of international credits, which led to lower carbon prices. The MSR allows for better matching of the supply of allowances to be auctioned with the demand. Under the revision of the EU ETS in 2018, the MSR intake rate (the percentage of the total number of allowances in circulation which is put in the reserve) until the end of 2023 was doubled from 12 % to 24 %, and the minimum amount of allowances placed in the MSR was doubled from 100 to 200 million. Moreover, from 2023 the allowances held in the MSR above the total number of allowances auctioned during the previous year should no longer be valid.

[Sectors at risk of carbon leakage](#) (determined by their intensity of trade with third countries, emission intensity and the share of carbon cost in gross value added) receive up to 100 % of their allowances for free until 2030. Other sectors, at lower risk of carbon leakage, receive up to 30 % of their allowances for free, with the amount decreasing after 2026 to reach zero in 2030. The list of installations eligible for free allocation of allowances is decided for a period of 5 years.

The level of free allocation is based on benchmarks, so that less efficient installations receive only as many allowances as the 10 % most efficient installations would need for the same amount of production; benchmarks are to be updated twice in phase 4 to adjust for technological progress and to avoid windfall profits. The allocation of allowances may be adjusted every year, based on a rolling average of 2 years, in case that production has decreased or increased by more than 15 %. If not enough free allowances are available, a cross-sectoral correction factor will be applied to reduce the amount of free allocations for all installations by the same percentage.

Member States are responsible for issuing emissions allowances and ensuring monitoring and reporting of the recipients' GHG emissions; they must use at least half of the revenues from auctioning for climate-related purposes. Two new funds have been established to support energy-intensive industrial sectors and the electricity sector in their innovation and investment challenges in the transition to a low-carbon economy. The [Innovation Fund](#) supports innovative low-carbon technologies in energy-intensive industries, carbon capture, use and storage of renewable energy, and energy storage. The [Modernisation Fund](#) supports the modernisation of the electricity sector and energy systems in 10 lower-income EU Member States.

In preparation of carbon pricing for maritime transport, [Regulation \(EU\) 2015/757](#) introduces a system for monitoring, reporting and verification of CO₂ emissions (MRV Regulation) from all ships calling at EU ports. It is being [amended](#) to align it with the global data collection system of the International Maritime Organization (IMO).

Parliament's starting position

In its [resolution on the European Green Deal](#) of 15 January 2020, the European Parliament called on the Commission to rapidly review the ETS Directive to align it with the increased GHG targets, including revision of the linear reduction factor and the rules for allocation of free allowances, and to address the potential need for a carbon floor price. It opposed the inclusion of road transport in the EU ETS and expressed reservations regarding the inclusion of the buildings sector. On the other hand, it supported the inclusion of the maritime sector.

On 16 September 2020, the Parliament voted to [amend](#) the MRV Regulation to require shipping companies to reduce their annual average CO₂ emissions relative to transport work by at least 40 % by 2030, and to amend the ETS Directive to include maritime transport from 2022.

European Council starting position

The [conclusions](#) of the December 2020 European Council meeting invited the Commission to explore ways to strengthen the ETS system, while maintaining its integrity and taking distributional concerns and energy poverty into account. They suggested that upcoming legislation should address the issue that beneficiaries of the Modernisation Fund do not receive revenues that are equivalent to the costs paid by ETS installations in those Member States.

Preparation of the proposal

A [public consultation](#) (online questionnaire with 29 questions) on the revision of the EU ETS was held from 13 November 2020 to 5 February 2021. There were 493 responses, with most coming from business associations and companies (70 %), followed by NGOs (10 %) and EU citizens (7 %).

The proposal is accompanied by a detailed [impact assessment](#) (IA). The IA addresses the measures to revise the EU ETS in a cost-effective way and in line with the target set in the European Climate Law, while accounting for the need for just transition and for all sectors to contribute to the EU climate targets. Specifically, the IA identified and assessed policy options for different elements in the following areas: strengthening the ETS; extending emissions trading to maritime emissions; extending emissions trading to buildings and road transport or all fossil fuels.

Strengthening the ETS covers three main options regarding a tighter emissions cap, a review of the MSR, a more targeted framework for carbon leakage (while incentivising innovation), and a review of the Innovation Fund. The IA analyses four main options for extending the EU ETS to maritime transport, the preferred option being integration into the current system. For extending emissions trading to other sectors, the two main options identified by the IA are to have a separate ETS either for buildings and transport, or for all fossil fuel combustion emissions not covered by the EU ETS.

The Commission's Regulatory Scrutiny Board adopted a [positive opinion with reservations](#) on the draft impact assessment report in April 2021, asking the Commission to make it less technical and more accessible to inform the key policy choices, highlight links with other 'Fit for 55' initiatives, and better justify why the ETS should be extended to the maritime sector and to transport and buildings.

EPRS has prepared an [initial appraisal](#) of the Commission's impact assessment.

The changes the proposal would bring

The Commission proposal to amend Directive 2003/87/EC concerns the ongoing phase 4 of the ETS (2021-2030). It consists of five main elements:

1. a reduced cap and a more ambitious linear reduction factor for GHG emissions;
2. revised rules for free allocation of allowances and the market stability reserve;
3. extension of the ETS to maritime transport;
4. a separate new ETS for buildings and road transport;
5. an increase in the Innovation and Modernisation Funds and new rules on using ETS revenues.

In addition, the Commission presented a [legislative proposal](#) to amend the MSR Decision (EU) 2015/1814 to strengthen the MSR, and two [legislative proposals](#) to amend the ETS Directive 2003/87/EC to raise ambition in the aviation sector and implement the CORSIA offsetting scheme for international aviation.

Increased linear reduction factor for GHG emissions

To align the EU ETS Directive with the increased GHG emission reduction targets set in the European Climate Law, the Commission is proposing to reduce emissions from the EU ETS sectors by 61 % by 2030, compared to 2005 levels. To achieve this target, the proposal increases the linear emissions reduction factor from 2.2 % per year to 4.2 %, to be applied after entry into force of the revised

directive. In addition, the emissions allowances cap would be adjusted downwards, as if the increased LRF had applied from 2021 ('rebasing'). The cap will be increased by allowances corresponding to the maritime transport emissions to be included in the EU ETS, derived from reporting under the MRV Regulation.

Free allocation

Protection against carbon leakage will still be in place through allocation of free allowances. However, the number of free allowances will gradually be reduced with a decreasing emissions cap and the proposed introduction of a [carbon border adjustment mechanism](#) (CBAM). Producers of products covered by the CBAM would receive 90 % of their free allocation in 2026, and 10 percentage points less each following year. The CBAM would gradually phase in a price on the GHG emissions linked to imports to the EU, with the overall aim of ensuring that the EU's climate targets are not undermined by less ambitious climate policies in other parts of the world.

The benchmark approach will be updated and will become more stringent to ensure a fairer and more transparent distribution of free allowances and to avoid applying the cross-sectoral correction factor. In addition, the maximum annual update rate will be increased from 1.6 % to 2.5 % from 2026. Moreover, to incentivise the adoption of low-carbon technologies, the free allocation would be reduced by 25 % for installations that fail to implement recommendations from the energy audits required by the [energy efficiency directive](#) or take equivalent measures to reduce GHG emissions.

Under the current rules, an installation using innovative technologies to reduce GHG emissions may fall out of the ETS and stop receiving free allowances if it reduces the capacities of its combustion units. This would place it at a competitive disadvantage relative to an installation with emissions below the benchmark level and which thus receives more in free allocations than it emits.

The proposal would allow installations to stay in the ETS after introducing low-carbon innovations, thereby also lowering the benchmark and encouraging more emission reductions. It makes the definitions of activities technology-neutral, refers to production capacity instead of combustion capacity, and reviews the benchmark definitions to ensure technology-neutral treatment of installations.

Market Stability Reserve

The MSR Decision (EU) 2015/1814 would be amended to enable a smoother intake of allowances to the reserve, the closer the surplus on the market is to the specified threshold, to avoid 'threshold effects' where one extra allowance in circulation can trigger the intake. From 2023, allowances above the level of auction volumes of the previous year would be invalidated, and the number of allowances in the MSR would be limited to 400 million. The revised MSR would include the aviation and maritime sectors in calculating the total number of allowances in circulation.

The MSR would have a separate section for buildings and road transport. To address the risk of excessive price increases in the new ETS for buildings and road transport, additional allowances from the MSR would be released in cases of sudden and significant price increases.

The 'Fit for 55' package contains a [separate legislative proposal](#) to strengthen the MSR by amending the MSR Decision to maintain the currently increased annual intake rate of allowances.

Maritime emissions

The proposal would extend the EU ETS to cover CO₂ emissions from maritime transport,³ specifically from large ships above 5 000 gross tonnage. The extension applies to all emissions from intra-EU voyages and to 50 % of emissions from extra-EU voyages and all emissions occurring when ships are at berth in an EU port. The same rules as for the other sectors would apply to maritime emissions. The extended EU ETS would cover around two thirds of maritime emissions, with the aim of incentivising energy efficiency improvements and low-carbon technologies, and of reducing the price difference between alternative and traditional maritime fuels.

Each shipping company regulated by the EU ETS would be attributed to the administering authority of a Member State. If the company is not registered in a Member State, it would be attributed to the Member State where it had the highest number of port calls in the previous 2 years.

The requirement to surrender allowances would be gradually phased in during 2023-2025 (20 % of verified emissions for 2023, 45 % for 2024, 70 % for 2025, and 100 % from 2026 onwards). Besides the general EU ETS rules on penalties, ships could be denied entry to a port if the shipping company has failed to surrender sufficient allowances for two or more consecutive reporting periods. The Commission would have to monitor implementation of the rules, report on the adoption of a market-based measure by the IMO and propose amendments to the ETS Directive, if necessary.

The MRV Regulation (EU) 2015/757 would be amended with respect to reporting of aggregated emissions data at company level and monitoring plans for ships under the scope of the Regulation.

A [study on the aviation and maritime sectors and the EU ETS](#) for the TRAN committee recommends aligning compliance cycles with the MRV Regulation, effective and flag-neutral enforcement, and use of revenues for energy transition in the maritime sector, also for shipping companies not registered in the EU. It warns of the potential shifting of maritime transport to avoid EU ports and the impact on EU trans-shipment ports.

Fuel distribution for road transport and buildings

A separate, self-standing emissions trading system for fuel distribution for road transport and buildings would be established, starting from 2025. Because the GHGs are emitted by small entities like households and car drivers, the regulated activity will be 'release for consumption' and the regulated entities will be fuel distributors for whom a monitoring and reporting system already exists under the excise duty system of [Council Directive \(EU\) 2020/262](#).

The regulated entities would need to hold a GHG emissions permit and report the amount of fuels placed on the market, starting from 2024. From 2026, they would have to surrender a corresponding amount of allowances, based on the carbon intensity of the fuels. The cap on emissions would be set in 2026, based on data from the Effort-sharing Regulation. It would gradually decrease, to achieve a 43 % reduction in emissions in 2030 compared to 2005 levels for these sectors, with a corresponding linear reduction factor. All allowances would be auctioned and none would be provided for free. Some allowances would be front-loaded to allow for a smooth start to the system.

The Commission has presented a [proposal](#) for a [social climate fund](#), which would use 25 % of the revenues from the new ETS for road transport and buildings. This would alleviate the social impacts of passing on the carbon costs to households, micro-enterprises and transport users.

The road transport and buildings sectors would still be included in the [Effort Sharing Regulation](#), so that national policies would continue to play a role in decarbonising these sectors. The Commission would have to report on the effectiveness, administration and practical application of the system by 1 January 2028, and propose amendments where appropriate.

Innovation Fund and Modernisation Fund

Under the proposal, the Innovation Fund would be increased by 50 million allowances (stemming from the allowances available for free allocation and for auctioning), and by 150 million allowances stemming from the new emissions trading system for road transport and buildings. Furthermore, allowances that would otherwise be distributed for free to sectors covered by the CBAM would be auctioned and added to the Innovation Fund. The scope of the fund will be extended to support projects through competitive tendering mechanisms such as [carbon contracts for differences](#).

The Modernisation Fund would be increased by auctioning an additional 2.5 % of allowances. The additional volume would be used to support the energy transition of Member States with GDP per capita below 65 % of the EU average in 2016-2018, which would help to further decrease the low-carbon innovation investment gap and to address distributional effects. At least 80 % of the funding would have to be used for priority investments listed in the proposal; the fund would not support investments in energy generation facilities that use fossil fuels.

Use of ETS revenues

Under the proposal, Member States would be required to use all the auction revenues, unless attributed to the EU budget,⁴ for climate and energy-related purposes, including decarbonisation in the road transport and buildings sectors. Furthermore, Member States may use part of the revenues for financial support to low-income households in the worst performing buildings.

Carbon capture and utilisation

Under the proposal, the obligation to surrender allowances would not arise for GHG emissions that are permanently chemically bound in a product, and thus not released into the atmosphere under normal use. The Commission would adopt implementing acts to specify the requirements.

Advisory committees

The European Economic and Social Committee (EESC) adopted an [opinion](#) (rapporteur: Stefan Back, Employers – Group I, Sweden) on the proposal on 8 December 2021, welcoming the overall ambition of the proposal but warning of possible impacts on EU industry, shipping companies and consumers. The EESC made critical remarks about the proposed ETS for road transport and buildings, and noted that the extension to road transport was decided against the sceptical views of the private sector, trade unions and NGOs.

The Committee of the Regions is preparing an opinion entitled '[Making ETS and CBAM work for EU cities and regions](#)' (rapporteur: Peter Kurz, PES, Germany).

National parliaments

Two [national parliaments](#) submitted reasoned opinions before the subsidiarity deadline of 8 November 2021.

The Irish [Houses of the Oireachtas](#) consider that the proposal, along with others in the 'Fit for 55' package, is in breach of the principles of proportionality and subsidiarity and question whether EU-level action is necessary, given that the proposal lacks sufficient quantitative and qualitative indicators to allow national parliaments to fully assess the implications. The reasoned opinion points out that the Irish Climate Action and Low Carbon Development (Amendment) Bill 2021 sets similarly ambitious targets for climate neutrality by 2050, and that Ireland intends to implement climate measures through the reallocation of revenue from a carbon tax that includes the road transport and buildings sectors. The concern is that the proposed new separate ETS for road transport and buildings, and the allocation of revenue through the social climate fund, are not adequately justified and would have a negative impact on the future scope of Ireland's carbon tax revenue, and on the ability of the Irish government to implement climate measures.

The [Czech Senate](#) considers that the proposal breaches the subsidiarity principle because the Commission has not delivered impact assessments in relation to individual Member States, their households and their economic sectors, thus preventing national parliaments from fully assessing all the implications and the possible added value of action at EU level compared to measures taken at Member State level. It is concerned about negative economic and social impacts, especially in lower-income Member States, and expresses particular concern about the proposed separate emissions trading system for road transport and buildings. Moreover, it states that the impact assessment at EU level is based on unrealistic estimates of the development of carbon prices.

Stakeholder views⁵

The revision of the EU ETS, as well as other legislative proposals in the 'Fit for 55' package, received mixed reactions from stakeholders. Many welcomed the increased ambitions while questioning the continued allocation of free allowances and expressing concern about the distributional impacts of the proposed separate ETS for transport and buildings.

[Business Europe](#) supports the central role of the EU ETS, recalls the importance of protection against carbon leakage, and calls for additional support for investments in breakthrough technologies for decarbonisation. They welcome the fact that transport and buildings are addressed in a separate ETS, while calling for reinvestment of the revenues into low-carbon solutions. [Eurelectric](#), representing the electricity industry, generally welcomes the proposal and calls for lowering the MSR thresholds and accelerating the reform of benchmarks.

[BEUC](#), the European consumer organisation, considers the separate ETS for transport and buildings to be a 'high-risk, low-reward measure', warning of its negative financial impact, especially on lower-income consumers. Moreover, it would not support the uptake of energy-efficient solutions and would distract policymakers from more effective sector-specific regulation.

[Climate Action Network \(CAN\) Europe](#) calls for higher ambition and [advocates](#) a 70 % emission reduction in the EU ETS sectors, compared to 2005 levels, to achieve an economy-wide 65 % emission reduction below 1990 levels. CAN Europe criticises the continued allocation of free allowances, and expresses concern about the social impact of the new ETS for transport and buildings on vulnerable consumers. The [Institute for European Environmental Policy](#) welcomed the extension of the EU ETS to cover over two thirds of emissions and called for ending the allocation of free allowances by 2030 and using ETS revenues to support lower-income households and climate-vulnerable countries.

[Bellona's](#) climate scoreboard rates the overall ambition as fit for the 2050 climate neutrality target. However, they consider the decrease in the free allocation of allowances to be insufficient and point out that the actual proportion of free allowances in the system would increase from 2021. Bellona welcomes the extension of the Innovation Fund, although they consider the amount available for industry to be insufficient to support the required rapid innovative and transformative change. Finally, Bellona calls for including waste incineration in the ETS.

[E3G](#) calls for earlier phasing out of free allocation and recommends strict climate conditionality criteria for the Modernisation and Innovation Funds. Access to the latter for central and eastern European countries should be facilitated through technical assistance for funding applications, as western European countries dominated the first call for proposals.

Distributional impacts were highlighted in a report by [CEPS](#), which stressed the contrast between the immediate carbon cost increases for citizens and the continued free allocation of allowances to industry. Similar concerns were raised by [Friends of the Earth Europe](#), who warned that including transport and buildings would lead to high energy prices, with unequal social impacts. [Bruegel](#) also argued that the most vulnerable may be most affected by the transport and buildings ETS, despite the establishment of the social climate fund.

The [International Chamber of Shipping](#) considers the extension of the EU ETS to maritime transport to be a 'piecemeal approach' to market-based measures, as it would apply to only 7.5 % of global shipping emissions. Instead, they propose that the IMO introduce a mandatory global levy for each tonne of CO₂, to reduce the price gap between zero-carbon and conventional fuels and support low-carbon fuel infrastructure in ports through a new 'IMO climate fund'. Likewise, the Asian Shipowners' Association [opposes](#) any proposal for unilateral or regional regulation of international shipping and considers the IMO to be the only appropriate forum for developing a market-based measure applicable to international shipping.

Legislative process

In the European Parliament, the proposal has been referred to the Committee on Environment, Public Health and Food Safety (ENVI); Peter Liese (EPP, Germany) was appointed as rapporteur. The Committee on Industry, Research and Energy (ITRE) is an associated committee.

The rapporteur presented his [draft report](#) on 14 January 2022. It would include shipping emissions fully in the ETS, from 2025 onwards, and establish an ocean fund that would use 75 % of ETS

revenues from shipping to support decarbonisation of the maritime sector. Waste incineration would be included in the ETS from 2028.

The new ETS could apply to all fuels (not just road transport and buildings) from 2025, with an option for Member States to opt out in respect of private road transport and private residential heating until 2027, if they can achieve their targets under the Effort-sharing Regulation by other means. Half of the additional volume for the Modernisation Fund should go to regions in transition, as defined in the Just Transition Fund Regulation.

Free allowances that are no longer distributed because of the CBAM would be added to a new 'carbon leakage protection reserve'. The Commission should assess the effectiveness of the CBAM by 28 February each year; if it is found to be ineffective against carbon leakage, the allowances from the reserve would be distributed to industry, otherwise they would be auctioned for the benefit of the Innovation Fund.

ETS installations would be required to draw up climate neutrality plans. The level of free allocation would depend on the efficiency of the installation and on achieving the targets in their climate neutrality plans. Installations that remove carbon dioxide from the atmosphere would receive the corresponding amount of ETS allowances.

Rail transport could be funded from ETS revenues, and at least 10 % of the Innovation Fund would be used to develop railways and local public transport. Moreover, the Innovation Fund should support innovation in the aviation sector and may be used to support agricultural breakthrough technologies, but not nuclear energy.

In the Council, environment ministers held a first exchange of views on the 'Fit for 55' package on 6 October 2021. The [progress report](#) of 6 December 2021 gives an overview of work in the Council and notes the diverging views on the proposed ETS for transport and buildings.

EP SUPPORTING ANALYSIS

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Vettorazzi, S. with Medeiros De Faria, A. P., ['Fit for 55': Revision of the EU Emissions Trading System](#), EPRS, European Parliament, January 2022.

[2030 climate target plan: extension of European Emission Trading System \(ETS\) to transport emissions](#), ENVI workshop proceedings, DG IPOL, European Parliament, June 2021.

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[Report on the functioning of the European carbon market](#), COM(2020) 740 final.

[2021 State of the EU ETS Report](#), ERCST, April 2021.

[Commission Proposal on the ETS Review: a cool-headed assessment](#), ERCST and Bloomberg NEF, 2021.

ENDNOTES

- ¹ The target of reducing emissions by 55 % by 2030 is also the EU's [nationally determined contribution](#) to the [Paris Agreement](#) target of limiting the global temperature rise to well below 2 degrees, while aiming to stay below 1.5 degrees.
- ² The gases covered by the EU ETS are carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF₆).
- ³ The [FuelEU Maritime](#) proposal, also part of the 'Fit for 55' package, addresses GHG emissions by the maritime sector by limiting the carbon intensity of the energy used on board ships, in order to support the uptake of sustainable fuels.
- ⁴ On 22 December 2021, the Commission presented a [legislative proposal](#) for a Council Decision amending the system of own resources of the European Union by adding new sources of revenue, including the EU ETS and the CBAM.
- ⁵ This section aims to provide a flavour of the debate and not to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

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First edition. The 'EU Legislation in Progress' briefings are updated at key stages throughout the legislative procedure.