ETS for road transport and buildings (ETS2)

Make Big Oil pay and don't exempt wealthy households

One year after the European Commission's landmark climate package, 'Fit for 55', it is now in the hands of the European Parliament (EP). We look at what is at stake for the European Green Deal and Europe's climate ambitions, as the lead committees of the EP vote to adopt key Fit for 55 proposals.

Context

In the years leading up to the Fit for 55 package, the EU was mulling a repeal of the Effort Sharing Regulation (ESR), the law that sets binding national climate targets for each member state. This would hand over responsibility for reducing emissions from road transport and buildings to a new EU carbon market. With emissions from road transport and buildings increasing by resp. 7% and 2% between 2014 and 2019, increased action incentives were needed. But T&E, together with most of civil society, did not think that letting governments off the hook for emissions from road transport and buildings was the right way forward.

T&E and others' successful campaign against the ESR's repeal led to a Fit for 55 package that not only kept national climate targets, but also increased ambition in car CO2 standards and added an additional tool for member states to reach their targets: a dedicated Emissions Trading System for road transport and buildings, or so-called ETS2.

Under this new ETS2, fuel suppliers like Total and Shell would need to buy pollution permits for each liter of fuel they put on the market. They would then pass on the cost of pollution permits to end-consumers, in the form of increased prices for refueling your car or heating your home. To shield low-income households from this price increase, the Commission proposed a new Social Climate Fund (SCF).

What is at stake as EU Parliamentary Committees vote on the Fit for 55 climate package?

What's good? What's bad?

Members of the ENVI Committee are proposing to start the ETS2 a year earlier than proposed by the Commission and to change the scope of the scheme.

On the one hand the ETS2's scope would be extended to all fuels not yet covered by the existing ETS (those used in small industries, agriculture, etc.). On the other hand, within the road transport and buildings sectors, it would apply only to commercial vehicles and residential buildings. In 2026, the Commission would need to report on a number of parameters to assess if 'the conditions are right' for an extension to private vehicles and residential buildings from 2029. Countries can also opt-in to move to full scope earlier.

While the MEP's strong emphasis on sufficient social policies as a precondition for carbon pricing is a good step forward, the scope reduction to commercial vehicles and residential buildings only is not the right answer. It will reduce the emissions impact of the ETS2 on road transport and buildings by three quarters. That would likely lead to the EU missing its 2030 target by 43% for those two sectors. For road transport the system would also be prone to fraud. As it would be an administrative nightmare to single out all commercial vehicles, the scope reduction would in practice only apply to trucks. But hauliers could easily game the system by refilling generic or light duty tanks and pumping out the fuel to their trucks afterwards.

The new ETS2 would come with a price cap of €50/tCO2 until 2030. When the price is approaching that level, there is a signal to the Commission and member states that urgent additional action is needed. While a price cap makes sense for private cars, a €50/tCO2 is too low for hauliers if we really want to drive a shift to zero-emission trucks.

The lead negotiators are proposing to further delay the start of the carbon price for citizens, if prices pre-2029 are consistently higher than the average price of March 2022. The problem is that no one knows how high salaries and living expenses will be 7 years from now. A better solution would have been to make the ETS2's start dependent on an average price (e.g. 3x higher than a 5 year historical average) or on annually updated price expectation forecasts.

When private vehicles and buildings enter the market, a provision mandating the fuel suppliers to absorb half of the carbon price is proposed to kick in. This is a smart way to finally make Big Oil pay. If the likes of Shell and Total pass on more than 50% of the costs, they would pay a fine into the Social Climate Fund (see T&E's briefing on this proposal here). Big Oil has been making record profits while citizens struggle to pay their energy bills.

Finally, the negotiators are proposing that all ETS2 revenues are spent on social action in the road transport and buildings sectors, with 25% being redistributed amongst member states for the same purpose via the Social Climate Fund (SCF). This will go a long way to ensuring a just transition in these sectors.

How should the proposals be improved?

1. **Include private cars and buildings from the start**, but shield low-income households from the impacts by making direct income support mandatory under the Social Climate Fund. This would significantly increase the budget available for investments in road transport and buildings, as wealthy households would still pay the full price.
2. **Make the fuel suppliers pay half of the carbon price from the start**, rather than only from 2029.
3. **Increase the price ceiling annually** by €10/tCO2, rather than leaving it fixed for 5 years.

4. **Top up the Social Climate Fund with revenues from the ETS1**, as the existing ETS also impacts consumer energy bills and could benefit from better redistribution to low-income households.

Next steps to deliver on Europe's climate goals

The ambition of Europe's Green Deal will be determined over the coming weeks as the Fit for 55 package process goes from European Parliament Committees for a Plenary vote in Parliament, and then to Trilogue negotiations with the European Council and European Commission. At any stage, Europe's ambition to decarbonise transport could be strengthened or weakened. It is critical that we maintain high levels of ambition and not allow Fit for 55 to be watered down.

The next steps for the ETS for road transport and buildings will be a vote in the European Parliament plenary during the week of June 6th, with trilogues expected to start once national governments agree on their position, possibly at the Environment Council on 28 June.

T&E Comment

"The ENVI lead negotiators have proposed an innovative way to make Big Oil pay. The new carbon price would be split between Big Oil and consumers, which essentially comes down to the EU shaving off a part of their profit margin. This is a strong step towards a just transition, and highly needed at a time when oil majors are making bumper profits off the war in Ukraine. Unfortunately they would only make Big Oil pay from 2029. Until then MEPs are proposing to limit the ETS2 to commercial vehicles and residential buildings only, letting 75% of road transport and building emissions off the hook. Rather than exempting all households from carbon pricing until 2029, they should make wealthy households pay, compensate the poor via the Social Climate Fund and make Big Oil contribute from the very start."

Further information

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