



MIND THE GAP!

Assessing Climate Action under the 'Fit For 55' Package

Climate Action Network (CAN) Europe is Europe's leading NGO coalition fighting dangerous climate change. With over 185 member organisations active in 38 European countries, representing over 1,700 NGOs and more than 40 million citizens, CAN Europe promotes sustainable climate, energy and development policies throughout Europe.

Introduction

The climate crisis remains the defining challenge of our time and Europe will play a significant role in determining whether we can avert the worst impacts of rising temperatures or whether people and the planet continue heading towards climate breakdown. In November 2019, the European Parliament declared a state of climate and environmental emergency, following the dire warnings of scientists, citizens and civil society that **the world is not on track to meet the objectives of the Paris Agreement**.

In response, the European Union agreed on a target to achieve climate neutrality by 2050 and to increase its nationally determined contribution (NDC). In addition and as a central part of the European Green Deal, the European Commission launched a comprehensive revision of the EU's climate and energy policy framework and architecture, the so-called 'Fit For 55' package, in summer 2021. The main objective of the review was to bring EU policy in line with the updated climate objectives enshrined in the EU Climate Law, including the target of achieving at least -55% net emission cuts by 2030.

The 'Fit For 55' legislative package contains proposals to update legislation affecting all economic sectors, including upgrades to the EU's main climate and energy legislation. Over the past years and despite the turmoil caused by the COVID19 pandemic and the Russian war against Ukraine, negotiations largely remained on track and climate and energy legislative updates proceeded steadily and simultaneously, in a slightly sequenced manner.

The following briefing focuses on the outcomes of the three central climate files - the EU Emissions Trading System (ETS), the Effort Sharing Regulation (ESR) and the Land Use, Land Use Change and Forestry (LULUCF) - as these are the three files formally implementing the EU's overall climate target for 2030. It is important to keep in mind that these files were negotiated simultaneously as part of a wider set of climate legislative pieces, many of which are

closely interlinked¹ and in parallel to the EU energy files which were concluded later and are not the focus of this briefing.

Based on the assessments in this briefing, both on the three individual files and on their collective impact, CAN Europe highlights the following recommendations:

- The EU and its Member States need to make use of every measure possible to further decrease emissions before 2030 in order to achieve **at least -65% emission cuts** by that date and climate neutrality no later than in 2040;
- These measures should include a consistency check of the revised legislation in light of the remaining EU greenhouse gas emission budget and the EU's **equitable contribution** to the Paris Agreement objectives, informed by the European Scientific Advisory Board on Climate Change (ESABCC);
- When implementing the revised legislation, **Member States should plan for higher domestic emission reductions** than foreseen under their respective national targets in order to enable the EU to move well beyond the -55 net emission reduction target. Such increased ambition should be driven bottom-up, particularly through the ongoing process of preparing their National Energy and Climate Plans (NECPs);
- The EU and its Member States need to advance the **socially just transformation of the economy**. Beyond strengthening instruments such as the Social Climate Fund, Europe needs to strengthen its protection of vulnerable groups and middle and low income households against climate risks and poverty. At the same time, heavy polluters, fossil fuel companies, overconsumption and excessive material use need to be taxed much stronger and revenue redirected at scale towards renewables, nature protection and the deep transformations necessary to achieve climate neutrality.

¹ While this briefing focuses on negotiation outcomes of the ETS, ESR and LULUCF Regulation, other legislative files negotiated in parallel and part of the 'Fit For 55' package also have impacts on the EU's overall level of climate action and ambition and are occasionally referred to in this briefing, in particular the revision of CO2 standards for cars, the establishment of a Carbon Border Adjustment Mechanism (CBAM) and a Social Climate Fund (SCF) and was also impacted by the 'REPowerEU' plan.

GENERAL ASSESSMENT OF THE 'FIT FOR 55' CLIMATE FILES

Collectively, the three climate files analysed in this briefing formally implement the EU's nationally determined contribution (NDC) and the ambition to reduce net emissions by -55% by 2030, compared to 1990, as enshrined in the EU Climate Law. Taking a look at the collective outcome of the negotiations on the three files, the following assessments can be made.

Overall ambition remains alarmingly off-track with the EU's fair share to the 1.5 target

Given the insufficiency of the current EU 2030 climate target to reflect the EU's fair share contribution, the revisions of the implementing legislation would have been a key opportunity to enable the EU to substantially move beyond the net -55% emission reductions.

However, policy-makers missed the leverage to increase the overall ambition beyond the level agreed in the current NDC. The marginally strengthened ETS and LULUCF targets are expected to inch EU net emission cuts by 2030 slightly beyond net -55% - potentially to -56.5% - but this increase remains highly insufficient in light of what the EU should deliver, taking into account its global responsibility as a major historic emitter and industrialised economy. **CAN Europe is calling on the EU to reduce gross emissions by at least -65% by 2030.**

In addition, the policy framework contains a number of flexibilities and loopholes, in particular in the Effort Sharing Regulation in the emissions accounting of the LULUCF Regulation, but also uncertainties related to the number of ETS allowances in circulation in 2030. Collectively, these flexibilities could lead to the EU missing its 2030 climate target or only meeting it on paper. It is therefore important to make use of upcoming reviews (such as the review of the Market Stability Reserve or the Effort Sharing Regulation trajectories) to ensure that some of these loopholes are addressed and closed before 2030.

Continued pressure to achieve at least -65% emission cuts by 2030 needed to reflect EU's fair share

In the global fight against the climate emergency this decade is critical to ensure the Paris Agreement objective of limiting global temperature increase to 1.5°C by the end of the century remains attainable. CAN Europe is calling on the EU to do everything in its power to further accelerate emission cuts in the near future and achieve at least -65% gross emission cuts by 2030 and climate neutrality by 2040 at the latest.

Any lack of action today not only requires accelerated and less cost-effective efforts later, but also entails a higher degree of societal costs and irreversible damages caused by today's insufficient level to act against the climate emergency for generations to come.

Besides the emission levels in 2030, what matters for the atmosphere are cumulative emissions released throughout the decade. Besides increasing the target for 2030, the most important measure to reduce cumulative emissions is to alter the emission reductions trajectories under the ETS and the ESR. This would not only avoid procrastinating urgently needed emission cuts, but also help to substantially reduce the greenhouse gas emissions budget the EU is expecting to use until 2030. Regrettably, during the negotiations policy-makers failed overall to act in this regard. Neither the rebasing of the ETS cap was strengthened (it was even slightly weakened in the final deal and therefore offsetting any improvements to cumulative emissions stemming from the slight increase of the ETS 2030 target), nor was the ESR trajectory starting level adjusted to actual emission levels. Based on the outcomes of the negotiations, the EU is expected cumulatively to emit 28.5 GtCO₂e during the entire decade².

It will be critical for Member States to move beyond their national targets through ambitious implementation of the framework, notably by delivering transformational national energy and climate plans (NECPs).

Need for comprehensive shift towards a social-ecological transformation

With rising energy and commodity prices, exacerbated by the Russian invasion of Ukraine, concerns about social fairness of the transition became central in the negotiations.

In this context, it is important to recall that **climate action is also social action**. Already now, the bulk of impacts and damages caused by the climate crisis, including its effects on health, are borne by the most vulnerable and these impacts are only set to multiply in the future if we fail to act sufficiently today. Social and climate protection therefore need to go hand in hand, but it will require a much broader effort from governments to tackle poverty and inequalities and ensure adequate protection of vulnerable groups than what we currently see.

The **establishment of the Social Climate Fund (SCF)** has been a positive step, but the negotiations have also unveiled a worrying imbalance of protection and distribution of efforts across society. Particularly the Council of the EU has blocked more progressive ways to ensure a fairer burden sharing and protection. On the one hand, it was mainly due to pressure from frugals in the Council that the SCF was diminished in the final deal, compared to the Commission proposal, with an envelope of 86 billion EUR over five years, dedicated to support vulnerable households in the EU. On the other hand, negotiators agreed to continue and even - compared to the Commission proposal - increase the number of free allowances handed out to heavy polluters in industry sectors under the ETS, therefore shielding them from paying for their

² According to our Paris Agreement Compatible (PAC) Energy Scenario, the EU should restrict itself to a remaining total greenhouse gas budget of 30GtCO₂e until reaching climate neutrality, no later than by 2040.

emissions. In total, the protection of heavy industry amounts to nearly 5 billion free allowances in the period 2021-2030, worth more than 460 billion EUR.

For the transformation agenda to move ahead it will be vital to ensure that efforts and benefits of the transition, as well as protection against excessive costs, be it in terms of measures taken or impacts stemming from lack of adequate actions, are more fairly distributed across society. As a general rule, the **polluter pays principle** as enshrined in the EU Treaties, should be fully applied, with bigger polluters and economically stronger actors shouldering a relatively higher cost than average and with targeted support for vulnerable groups and low-income households.

INDIVIDUAL ASSESSMENT OF THE 'FIT FOR 55' CLIMATE FILES

a) Revision of the Emissions Trading System (ETS)

One of the key pillars of EU climate policy, the EU Emissions Trading System (ETS) is the EU's carbon market and addresses emissions in the power, industry and aviation sectors. Next to the Effort Sharing Regulation (ESR) and the LULUCF Regulation, it is the main instrument to implement the EU's 2030 climate target, its nationally determined contribution (NDC) under the Paris Agreement. Set up in 2005, this cap and trade system allocates emission permits or allowances equivalent to 1 tonne of CO₂ emissions to each of the more than 11,000 installations and aircraft operators covered by the system and defines a total fixed amount of allowances in the system (cap) which declines over time. Allowances are either handed out for free or have to be bought at auction price and can be traded between market participants, thus creating financial incentives for sectors covered to decarbonise and to investors to channel capital towards cleaner technologies. For the past decade, the system has been marked by notorious failures, particularly in the form of an almost decade-long irrelevant carbon price driven by a historic glut of permits, a de facto exemption to the polluter pays principle to heavy industrial polluters and an insufficient level of overall ambition.

The recent reform in the context of the 'Fit For 55' package which was launched in summer 2021 and concluded with the agreement of informal negotiations between the three EU institutions in late December 2022, ventured to address many of the shortcomings listed above and adjust the overall ambition of the scheme in line with the EU's 2030 target of achieving net -55% emission cuts.

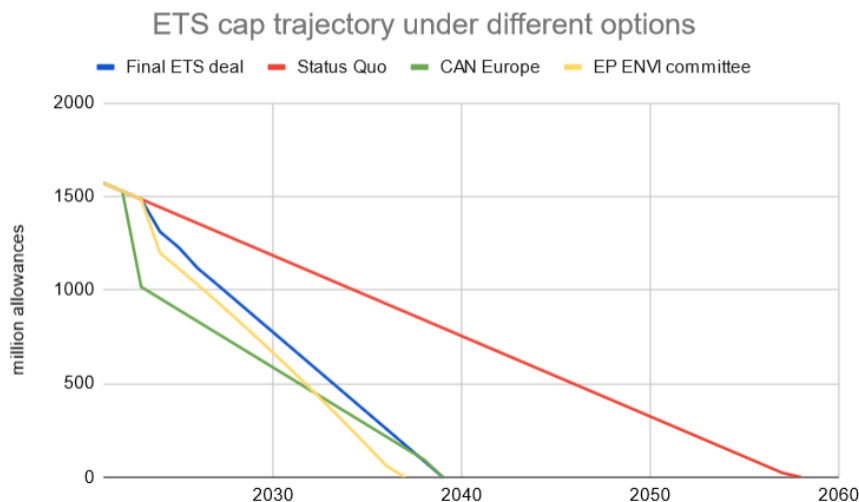
In the following the outcome of the negotiations will be assessed in light of [CAN Europe's position on the ETS revision](#) along four pillars: i) overall level of ambition, ii) resilience of the system to external shocks, iii) application of the polluter pays principle and iv) ETS investments into climate action.

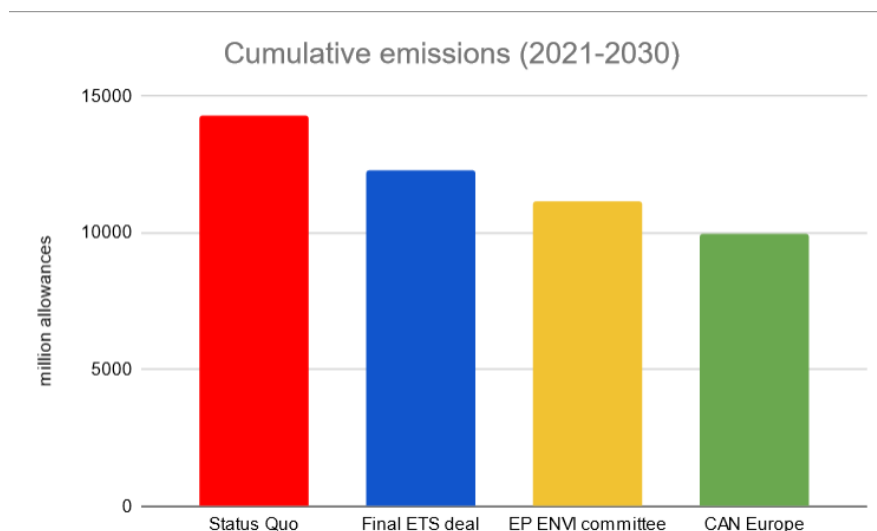
Increasing the system's overall ambition level

The recent reform increased the level of ambition of the ETS from achieving -43% emission cuts by 2030, compared to 2005 levels, to **-62% emission cuts**. This ambition level will be achieved through a combination of a sequenced reduction or **rebasing of the ETS cap** (by 90 million allowances in 2024 and by 27 million allowances in 2026) and an increase of the **linear reduction factor** (LRF) which determines the annual rate of decrease of the cap from 2.2% to 4.3% in the period 2024-2027 and to 4.4% in the period 2028-2030. This implies that the ETS cap will hit zero in 2039 instead of only in 2058 as the pre-reform system.

Though an important step forward, **policy-makers failed to bring the system in line with the 1.5 target of the Paris Agreement**. For the ETS to contribute to the Paris objective, emission cuts of at least -70% by 2030 would have been necessary. The EU legislators - the European Parliament and the Council of the EU - therefore missed a crucial chance to enable the EU to meaningfully overshoot its insufficient headline climate target of -55% net emission cuts by 2030.

Ultimately, what counts for the climate is what is allowed to be emitted into the atmosphere, thus the cumulative emissions over the entire trading period. Sadly, the final positions of the European Parliament, the Council of the EU and the European Commission were almost equally weak in this regard (12,315 MtCO₂e in the final deal against 12,314 MtCO₂e in the Commission proposal and the Council position and 12,246 MtCO₂e in the Parliament's position). The most promising improvement to the system's ambition was only captured in the position of the European Parliament's Environment committee report (which would have led to 1,170 additional cumulative emission cuts), but was unfortunately rejected in plenary.





A noteworthy addition to the final deal is a provision on the role of the **EU Scientific Advisory Board on Climate Change (ESABCC)** which can, on its own initiative, provide advice on the need for additional Union measures, including a revision of the ETS linear reduction factor.

Other elements impacting the overall ambition also include the extension of the **scope of the existing ETS**. On the downside, policymakers failed to extend the carbon market coverage to intercontinental flights (once again prolonging the notorious stop the clock derogation at least until a review in 2025), but managed to agree on setting up a monitoring, reporting and verification system for non-CO2 emissions in the aviation sector in 2025 and to present a proposal to address these in 2028. The final deal also foresees the extension of the system to maritime emissions, covering all domestic shipping emissions, with some notable exemptions for example for smaller islands, and 50% of extra-EEA voyages. In this context, negotiators also agreed on an end to grandfathering in the aviation sector: free allowances will be progressively phased out completely by 2026. The newly incorporated shipping sector will likewise see a stepwise phase out of free allowances in the same time horizon.

Municipal waste incineration was not incorporated yet into the ETS, but could be as of 2028 hinging on the conclusions of a review report by the Commission in 2026.

Strengthening the resilience and responsiveness of the system

One of the most notorious shortcomings of the ETS since its inception has been the persistence of a significant number of surplus allowances (or allowances in circulation) which have pushed the carbon price below 20 EUR for an entire decade³. A possible solution to prevent a deflation of the price to such low levels would have been the introduction of a **carbon floor price** within the ETS. Yet, given the EU's limited competences on fiscal measures, none of the institutions had included a call for such a price floor in the course of the negotiations⁴. As a second best option, the **market stability reserve (MSR)** of the ETS which absorbs and cancels allowances in times of surplus (and reinjects allowances in times of scarcity) has been strengthened to increase the responsiveness of the system to external shocks and tackle the obstacle of historic surplus allowances.

In the final deal, negotiators agreed to improve the market stability reserve in line with the Commission's proposal, which will make the instrument more responsive than under the status quo. However, negotiators rejected the proposal of the European Parliament, which CAN Europe supported, to decrease the triggering thresholds for the intake rate in line with the linear reduction factor. This would have further reduced the number of surplus allowances in 2030 by 413 million allowances.

A positive signal was that negotiators rejected the Parliament's controversial proposal to **limit market access** to only regulated entities which would have likely decreased the liquidity and overall resilience of the market.

Policymakers however loosened the **rules on market intervention in case of excessive price fluctuations**, as negotiations became increasingly impacted by the energy price and inflation crisis.

Unfortunately, an important element to ensure market resilience was not further strengthened: the unilateral cancellation of allowances in response to additional climate measures at national level (such as coal power plant shutdowns driven by plans for earlier coal phase outs) remains optional and member states are only "strongly encouraged" to delete potentially freed up allowances⁵.

³ To provide some context, this figure needs to be compared to the social cost of 1 tonne of carbon which theoretically the carbon price should internalise. While there are different approaches to quantifying this cost, the German environmental agency has estimated it to be around [180 EUR/tCO₂e](#). For an overview of the ETS price over time, see Sandbag's carbon price viewer: <https://sandbag.be/index.php/carbon-price-viewer/>

⁴ In its [impact assessment](#) to the ETS revision proposal, the European Commission contemplated a way around this legal challenge through an auction reserve price introduced in the MSR. This would have meant that, if the clearing price of an auction of allowances would not reach the auction reserve price, then the auction is cancelled. In that case, the corresponding volume of allowances to be auctioned would be added to the MSR, thereby quickly decreasing the supply of allowances to the market.

⁵ It is important to uphold pressure on national governments to make use of the procedure enshrined in article 25 of this [ETS delegated act](#) which implies that member states need to notify the Commission of their intention to cancel allowances by filling out and submitting the one page annex included in the delegated act at the latest by 31 December of the calendar year following the year of the closure installation. This fairly simple procedure often necessitates political pressure, as governments usually argue they would lose out potential revenue from these allowances.

Fully applying the Polluter Pays Principle

Arguably the biggest political battle in the negotiations on the ETS revision surrounded the continued handout of free pollution permits to heavy industry. Heavily criticised by civil society, progressive industry actors and the European Court of Auditors for creating a barrier to industrial decarbonisation, energy-intensive industries have been shielded from the polluter pays principles (more than 97% of industrial emissions were granted free allowances over the third trading phase based on largely unproven arguments on the risk of carbon leakage). By being exempted from paying the full carbon price and receiving too many allowances compared to their emissions, energy-intensive industries made billions in windfall profits from selling overallocated allowances and yet failed to achieve meaningful and systemic emission reductions since the establishment of the ETS⁶.

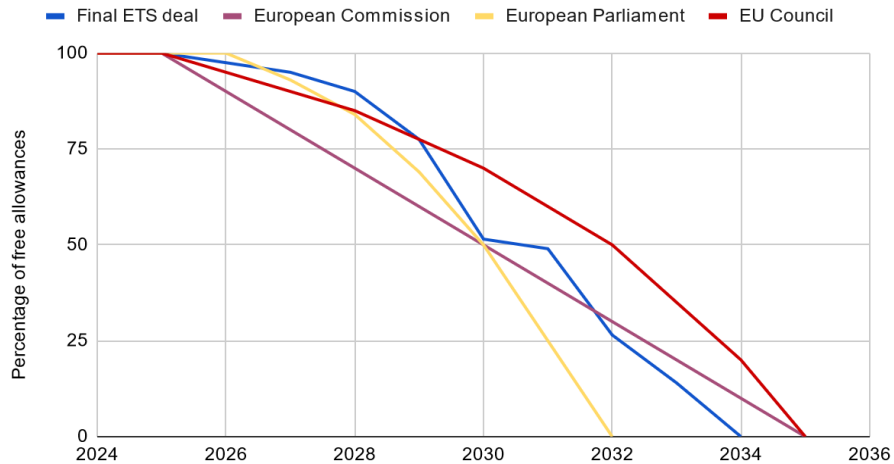
There is finally an agreed end of free allowances for sectors covered by the Carbon Border Adjustment Mechanism (CBAM) - cement, iron and steel, aluminium, fertilisers, electricity and hydrogen. However, instead of a rapid and immediate **phase out of free allowances** as demanded by a broad coalition of civil society and progressive industry⁷, policy makers agreed to kick the can further down the road (full phase out only in 2034) and provide billions of free allowances worth hundreds of billion euros to heavy polluting industries. Free allowance are not only delaying the decarbonisation of critical industry sectors, but they also contribute to the maintenance of implicit fossil fuel subsidies. According to the IMF these constitute the largest form of fossil fuel subsidies both in the EU and internationally⁸.

⁶ See the 2020 European Court of Auditors special report [here](#) and Carbon Market Watch's monitoring of industry windfall profits [here](#).

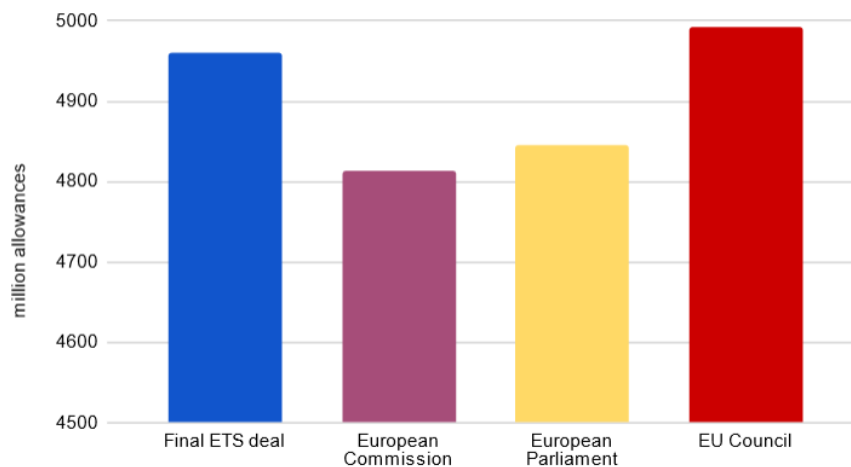
⁷ See joint call to end free allowances from spring 2022 [here](#).

⁸ IMF Working Papers (2019). Global Fossil Fuel Subsidies Remain Large: An Update Based on Country-Level Estimates [here](#).

Phase out of free allowances in CBAM sectors



Cumulative free allowances, 2021-2030



The co-legislators in Parliament and Council were seemingly outbidding each other in watering down the Commission proposal and the final deal is a severe deterioration leading to 147 million additional free allowances handed out to CBAM-sectors. With carbon prices currently hovering around 90 EUR, the 4.96 billion **free allowances that will be provided to industry over the whole trading period 2021-2030 amount to more than 460 billion euros.**

As a slight, though marginal, improvement, a malus system for the **conditional reductions of free allowances** was introduced as a result of the trilogues negotiations. Stationary installations which fail to implement the recommendations of their energy audits or of the certified energy management system (as mentioned in the Energy Efficiency Directive (EED)) will see a 20% decrease of their free allowances. In addition, the 20% worst performers will be subject to an

additional conditionality: from 2026 onwards, they will have to develop and implement climate neutrality plans at installations level, the failure of which can also lead to a reduction in free allowances.

Next to the conditionality requirements, a bonus system was also introduced to reward 'best performers'. Best performers, based on a given product benchmark, will be excluded from the application of the cross-sectoral correction factor.

Regrettably, the final deal allows for **30% additional free allowances** for district heating under certain conditions and if equivalent investments are made to reduce emissions before 2030.

While the final deal also provides for a slight increase of the annual improvement rate of the lower **benchmark** (from 0.2% to 0.3%), it includes a full exemption to any improvements of the hot metal benchmark which is of critical importance to the steel sector.

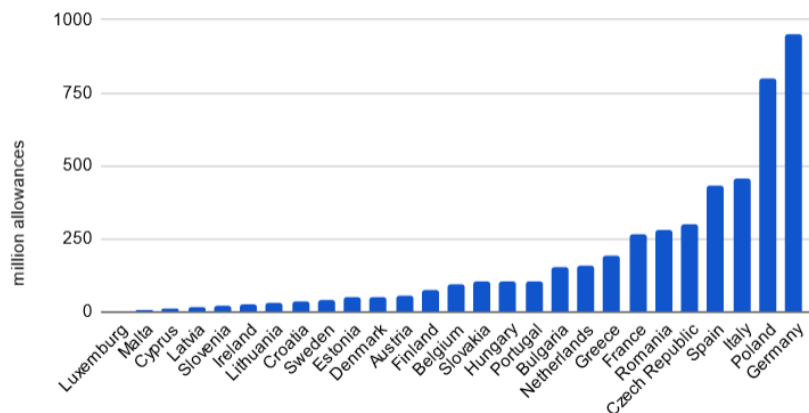
Funding climate action

The sale of ETS allowances brings about **substantial revenues** to EU countries (i.e. nearly €25 billion in 2021 alone). The reform resulted in important improvements as to how EU countries have to spend these revenues. In the past, member states were only recommended to spend at least 50% of their annual revenues on climate-related purposes listed under article 10(3) -, leading to billions of euros lost to climate action. There was also a practice in EU countries spending revenues on projects outside the scope envisaged by the ETS directive (e.g. Poland on nuclear energy in 2021)⁹. The final deal now makes all revenue spending mandatory to be used for investments that are specifically referred to in the spending categories under article 10(3). Some changes were made to these spending categories, which now include good things e.g. renewable energy communities, ecosystem restoration, soil sequestration, national climate dividend schemes with a proven positive environmental impact; but also things like direct air capture (DAC) and storage or investments in projects addressing "any residual risk of carbon leakage in [CBAM] sectors". Proposals for spending targets on specific categories (i.e. 10% for public transport and international climate finance) were rejected.

Unfortunately, no substantial improvements were made on the transparency and reporting requirements: EU countries now need to specify which national projects are consistent with national energy and climate plans (NECPs) and territorial just transition plans (TJTPs), and provide a reporting that is sufficiently detailed to enable the Commission to assess EU countries' compliance with the spending categories. Unfortunately, EU countries can still report on "the equivalent in financial value of [their] revenues" (meaning ETS revenues may not be additional to national budget spending on climate). Arguably, EU countries may also still be allowed to spend ETS revenues on so-called 'industry compensation schemes' essentially reimbursing installations for part of the paid carbon price, for sectors covered by the CBAM.

⁹ See especially WWF reports on the subject [here](#) and [here](#).

Expected allocation of auctioned allowances per member state, 2021-2030



The **ETS Modernisation Fund** was also improved. In addition to the existing tier (with an expected volume of around 270 million allowances over the whole trading phase), a second tier to the fund pooling an additional 2.5% of total allowances will be made available to all current beneficiaries, plus Greece, Portugal and Slovenia (amounting to over 220 million allowances over the period 2024-2030). While the share of priority investments in the first tier was increased in line with the Commission proposal (to 80%) and the second was given a 90% priority investment share, the Council of the EU managed to significantly water down the initial proposal which was meant to keep the entire Fund free of all fossil fuels: if compliant to the criteria of the Taxonomy Regulation and “duly justified for reasons of ensuring energy security” fossil gas investments will still be eligible.

The **Innovation Fund** on the other hand has fallen victim to a scramble for allowances, especially in the context of the Commission’s proposal to revert to the ETS in order finance some of the measures included in its ‘REPowerEU’ plan as a response to Russia’s aggression against Ukraine¹⁰. Ultimately, although increased in size compared to the status quo, the fund which is meant to provide investments in clean and innovative technology scale up, particularly in energy-intensive industries, turns out smaller than any of the proposals and positions of the institutions (with a total portfolio of 600 million allowances).

¹⁰ In May 2022, the Commission had proposed to generate 20 billion EUR from auctioning possibly around 200 to 250 million allowances from the market stability reserve (MRS) in order to provide additional finance to Member States for delivering ‘REPowerEU’ objectives via the Recovery and Resilience Facility. The financial scheme included the possibility to finance investments into new fossil infrastructure. This was [strongly criticised by NGOs](#). This proposal was eventually rejected by co-legislators: the final deal provides instead an additional amount of 12 billion EUR from the Innovation Fund, and 8 billion EUR that are raised by frontloaded allowances allocated to member states for auctioning. The final agreement equally stipulates that the funds raised through the Innovation Fund and the frontloading of ETS allowance cannot be used to finance fossil fuel infrastructure investments.

Biomass and Carbon Capture and Use (CCU)

The wording around the accounting and potential zero-rating of the emissions factor of **biomass** has not been strengthened beyond the Commission proposal. The Commission is thus charged with issuing implementing acts to apply the sustainability criteria of the Renewable Energy Directive and specify accounting rules for a mixed (zero-rated and non zero-rated) biomass sources, renewable fuels of non-biologic origin and recycled carbon fuels.

The final deal also failed to close another loophole related to the treatment of **carbon capture and use (CCU)** technology under the ETS. Should carbon emissions be permanently chemically bound in a product in a way that the emissions would not be released into the atmosphere “under normal use” and after the end of life of the product, no allowances need to be surrendered for these emissions.

Establishment of a new and adjacent ETS for buildings, road transport and additional sectors (ETS2) and the creation of a Social Climate Fund (SCF)

EU legislators also agreed on establishing a new, separate carbon market covering emission from the combustion of fossil fuels in the road transport, buildings sectors and other sectors¹¹. These sectors continue to be covered by national level climate targets under the Effort Sharing Regulation, hence the **new ETS2 serves as a backstop measure**, while national governments retain ultimate responsibility to ensure that emissions in these sectors are sufficiently cut.

In addition, a **Social Climate Fund (SCF) was created in order to provide targeted support for vulnerable households and people in energy and transport poverty**, thereby contributing to making the energy transition socially just.

Given the large differences in positions on this contentious part of the package, the final outcome is better than expected. In the final deal the scope of the new ETS2 was extended to also include emissions from fossil fuel combustion in small industry installations currently not covered by the existing ETS, but not to private planes or ships which thus remain outside of the EU carbon markets. Emissions in the covered sectors will be capped and allowances will decrease to ensure that emissions decrease by -43%, compared to 2005, in 2030. Similar to the revised spending criteria of the ETS1, all revenues generated by the ETS2 have to be spent on climate action.

While private households will be covered¹², several safeguards were agreed to shield citizens from excessive prices: first, the starting date of the scheme, scheduled for 2027, can be

¹¹ The final ETS2 was extended to include fossil fuel combustion for heating in industrial processes, mainly applying for SME installations currently falling out of the scope of the ETS1.

¹² The European Parliament had argued for an exclusion of private cars and buildings.

postponed for 1 year if average gas or oil prices remain extraordinarily high¹³. Second, provisions were agreed that would soften the start of the scheme, inter alia by injecting allowances from the MSR in case the price surges above a temporary ceiling of 45 EUR/tCO_{2e}. Third, regulated entities need to report to the Commission how much of the carbon cost is passed on to consumers on average in order to monitor improper practices in the cost pass-through.

It was also agreed to allow Member States with a national carbon price system, applying a price higher than the ETS2 price, can opt out of the system until 2030, under the condition that they cancel the emissions quotas as a result of the opt-out and designating an equivalent of the expected revenues for climate spending.

Despite strong pressure from the Council to significantly diminish its size, a Social Climate Fund (SCF) was created for the period 2026-2032 which means it will be operational at least one year ahead of the start of the new ETS II. Since member states have to co-finance activities supported by the fund by 25%, the overall budget to support vulnerable households is 72 billion EUR over these seven years.

b) Revision of the Effort Sharing Regulation (ESR)

The Effort Sharing Regulation (ESR) covers road transport, buildings, agriculture, small industry and waste sectors - those not covered by the Emissions Trading System. Together, those sectors are responsible for 60% of the EU's greenhouse gas emissions. To cut the emissions in these sectors, the ESR establishes collective and national binding targets and sets up annual emissions allocations (AEAs) for each Member State for the 2021-2030 period.

On 14 July 2021, the European Commission submitted a proposal to amend the binding annual emissions reductions by Member States as part of the 'Fit for 55' package. The Commission proposed that - to contribute to the new climate ambition set by the Climate Law - ESR sectors should achieve a collective reduction of 40 % by 2030 (compared to 2005). According to [CAN Europe's position](#) however, the EU should achieve at least 50% emission reductions in the ESR sectors by 2030 (compared to 2005 levels) to do its fair share in reaching the Paris Agreement goal.

After the launch and internal discussions, the Parliament and the Council adopted their positions on 8 and 29 June 2022, respectively. The trilogues between the Council, Parliament and the Commission concluded on 8 November 2022, [the agreement was later approved](#) by the ENVI committee of the Parliament on 16 January and the final Plenary vote in April 2023.

ESR flexibilities

¹³ This will apply either if the average price of gas in the first 6 months of 2026 is higher than the average gas price in February and March 2022 or if the average price of Brent crude oil in the first 6 months of 2026 is higher than double the average price of oil during the 5 preceding years (2021-2025).

The revised ESR in a lot of ways resembles the Commission's proposal that was put forward in 2021. Despite a more ambitious position of the European Parliament and a strong push from civil society, there were only minor improvements to the Commission's 2021 version, which did not do the trick. **The ESR agreement still leaves big doors open to use flexibilities and loopholes - claiming emission reductions that happened in the past, in other countries, in other sectors – instead of real domestic emission cuts in ESR sectors. Compliance and governance rules were also not strengthened.** Without strong consequences of non-compliance, transparency and access to justice we are risking overshooting the European target.

The flexibilities were introduced by the previous 2018 ESR to help countries achieve their targets and “take into account certain national particularities”. In practice, these flexibilities allow countries to cover up any gaps in delivering their national binding targets and have the potential to delay action. First, countries are allowed to borrow a limited amount of allocations from the following year to bridge shortcomings in the running year; second, they can bank excess allocations for use in later years and third, they can transfer (=sell) allowances to other Member States. These flexibilities were only slightly tightened as a result of the review.

The ESR also allows certain Member States to use a portion of EU ETS allowances (maximum 101 Mt) and net removals from LULUCF for compliance, hence cover up emissions, in the ESR.

CAN Europe's position is that carbon removals must not serve as offsets for emission reductions. This creates a dangerous precedent and trade-offs between sink enhancement efforts and mitigation action, while both are urgently required and must be maximised separately and additionally. We also argued that ETS reductions must come on top of national efforts in order to bring the maximum reductions to deliver on the climate goal and not be used instead.

In addition to all these flexibilities, the ESR establishes a “Safety reserve”, available in 2032 under some conditions to Member States with problems in achieving their 2030 target - inflating the budget with 105 Mt CO₂e extra emissions.

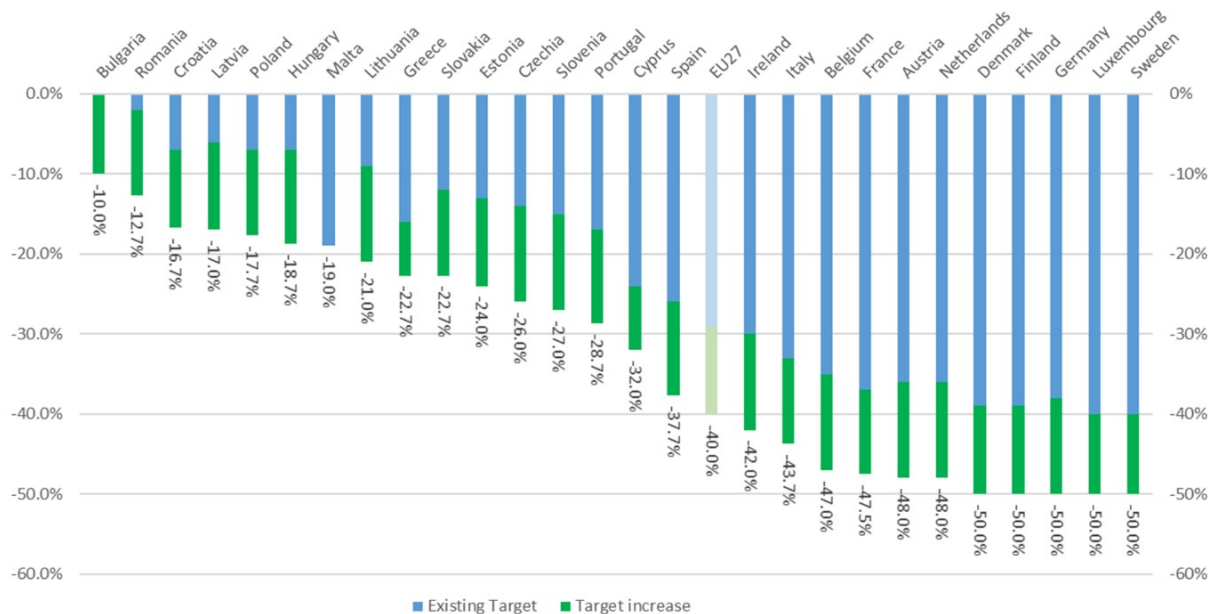
The following list shows how ESR flexibilities were restricted or extended in the final agreement:

- Limits on banking have been lowered. From unlimited banking to a 75% limit for the year 2021, from 30% limit to 25% in 2022-2030;
- Limits on borrowing of AEAs have been decreased to 7.5% from the following year from 2021 to 2025, and 5 % for the rest of the period;
- Possibility to trade emissions quotas have slightly increased, but Member States will have to disclose more information concerning the trading and the revenues should be spent on climate measures;
- A Member State may transfer (sell) up to 10 % of its annual emission allocation for a given year to other Member States in 2021-2025, and up to 15 % in 2026-2030. The receiving Member State may use the transferred AEAs until 2030. This is quite problematic, because the purchased allocations do not expire, and can be used until the end which does not prompt for timely and early reduction efforts and represents a form of “hidden” banking as past allowances remain in the system;
- No change to the Safety Reserve;
- The ETS flexibility was maintained, with an adjustment for Malta (101 Mt)

- The use of the LULUCF flexibility was maintained, but split up into two five-year sub-periods. Each period is capped (to 131 Mt), corresponding to half of the total amount of net removals allowed for each Member State.

Overall ambition and emission trajectories

Following the ambition of the ‘Fit for 55’ package, EU countries will have to cut emissions by 40% compared to 2005 levels in ESR sectors (up from 30%). This is reflected in the Annex I of the updated ESR an can be seen on the graph below:



Source: European Commission

The **distribution of the effort** between the EU 27 did not change from the previous range (according to the distribution agreed in 2018). Most of the countries must increase their emission reductions by approximately 10-11% from their previous ESR target.

The annual allowances (AEAs) are, from a climate perspective, as important as the targets in the ESR legislation, as they identify what the atmosphere sees, and define (together with similar annual allowances in the ETS) what the EU will contribute to climate change in the coming decade.

Therefore we must take a closer look at the emission pathway - the trajectory to 2030 - determined by the annual emission caps. This is not a straight line from 2021 emissions to the -40% new target, but a bumpy one with an adjustment mid-way.

Regarding the **starting level** and methods: for 2021 and 2022 the AEAs set in the 2020 Commission implementing decision (i.e. the “old” ESR national allocations) would remain valid.

Then, from 2023 to 2025, new AEAs will be allocated based on the starting value of the average of the greenhouse gas emissions in 2016-2018 of each Member State. This level of course represents a higher starting value than actual emission levels in 2020 or 2022. **The surplus resulting from this method could amount up to 63 Mt in 2021**, 75% of which countries can “bank” or trade for later use under the current rules.

The 2018 ESR provided a linear pathway from 2021 to 2030, but now, for the period from 2026 to 2030, the Commission will readjust the AEAs in 2025, on the basis of new data from the national inventories - in other words taking into account the actual 2021, 2022 and 2023 emissions. (By that, the Commission will change the basis of calculation - they will take the average of greenhouse gas emissions in 2021-2023 and place this value to nine-twelfths between 2023 and 2024, and apply that as the starting point of the new, post-2025 trajectory.)

This means that from 2026 onwards, the trajectory is not yet set in stone, it will depend on the emissions in 2021-2023 that could be higher than expected. The Commission proposed this review clause because the climate effect of the economic recovery from Covid was unknown at the time, and countries later argued they also need to prepare for unforeseen circumstances following the Russian invasion of Ukraine in 2022.

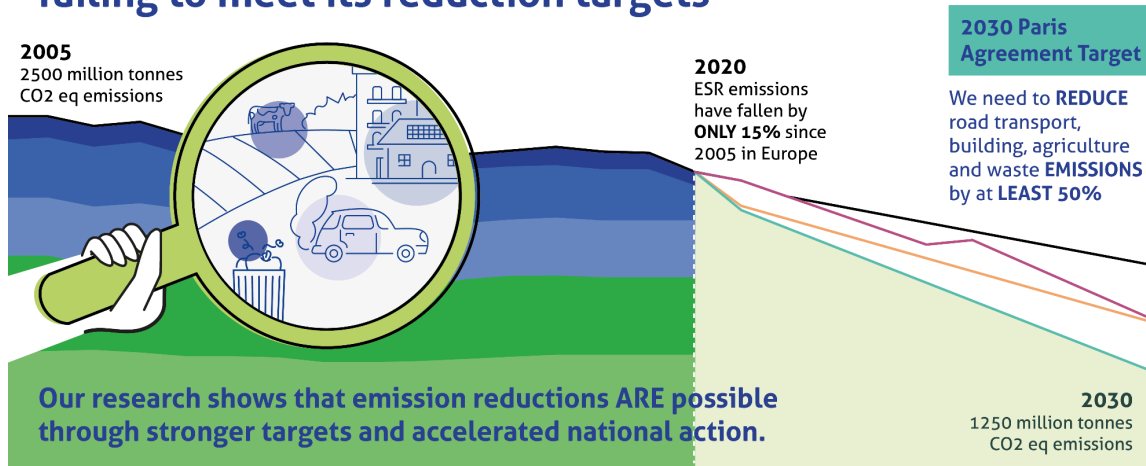
This method however **leaves a great uncertainty in terms of final reduction pathway and emission budget under ESR - the impact of which not yet known, but likely resulting in a more generous budget**. Overall, the AEAs in 2026 will be more than they would be if there was no review - in a period when we would need to tighten the number of allowances and not loosen them.

In addition to the flexibilities, the 2018 ESR established a ‘**Safety reserve**’ - available in 2032 under certain conditions, to (mostly Central and Eastern Europe) Member States with problems in achieving their 2030 greenhouse gas emissions target. Failing to remove this Safety Reserve, **105 Mt allowances** are further inflating the emission budget.

As described above, the **ETS and LULUCF credits** that can be brought under the ESR for compliance together also represent **additional (legal maximum) 363 Mt emission allowances - theoretically**. However, it is likely that not all countries will be able to build up a surplus in the LULUCF sector and the use of ETS allowances also depends on decarbonisation of the industry sector.

Another loophole in the final agreement is that - despite progressive amendments from the Parliament that were rejected - countries will be allowed to discount emissions from unsustainable biomass in their national greenhouse gas inventories (continued “zero-rating” of emissions from biofuels, bioliquids, and biomass, regardless of sustainability and emissions savings criteria).

Unambitious goals and loopholes mean the EU Effort Sharing Regulation is failing to meet its reduction targets



Compliance, transparency and access to justice

The future of the ESR and national binding targets under the ESR after 2030 are uncertain. These are secured until the end of the decade (the next 7 years), however there is no guarantee that the Effort Sharing system will continue until the EU reaches its climate neutrality goal¹⁴. The final version of the Regulation leaves the door open for discussions at a later point - the Commission will submit a report within six months of each global stocktake on the operation of the ESR, and assess the need for legislative proposals for the period after 2030.

Planning, monitoring and reporting rules are set under Regulation (EU) No 2018/1999 on the Governance of the Energy Union and Climate Action (the Governance Regulation) and in the ESR itself. The reporting and reviewing mechanisms after the review are exactly the same as they were since ESR was first established.

The rules governing the annual reviews and compliance checks lack the stringency necessary to create a real deterrent against failing to meet national climate targets.

MS have to report on their annual emissions, the Commission evaluates and reports on this data, and requires MS to submit a 'corrective action plan' if their progress is not sufficient. A slight improvement that now this corrective plan of a Member State must include a detailed explanation of the reasons and an assessment of how the funding for climate action was or would be used. The plan, as well as the Commission opinions and Member State's justifications, must be made public.

¹⁴ In the public consultation on the EU 2040 climate target, for example, the European Commission is contemplating on introducing economy-wide national climate targets. Whether these would be added under the ESR or replace current ESR targets is uncertain.

Then, every five years, the European Commission performs a more thorough compliance control and compiles a report - in 2027 for 2021-2025, and in 2032 for the 2026-2030 period. Non-compliance in the end could result in legal consequences (infringement procedure against the given country).

We consider this enforcement framework too weak and not up to the challenge of preventing national breaches of emissions reductions requirements. Moreover, there is a concern that retrospective compliance checks in 2027 and 2032 cannot have an effect on the past emissions, which - in case of an overshoot of the EU target - would have disastrous effect on the climate.

The inclusion of access to justice - the right for the public to bring governments to national court if they breach their ESR or climate and energy planning obligations - would have been an essential instrument to make member states accountable. But access to justice was only included in the recitals (16b) - “Public scrutiny and access to justice are an essential part of the democratic values of the Union and a tool to safeguard the rule of law.” This language is not binding in itself, whereby the EU misses a chance to comply with the Aarhus Convention and to reinforce the national ownership of the ESR targets.

In terms of implementation, the Governance Regulation requires Member States **to adopt national energy and climate plans (NECPs) for the 2021-2030 period** to deliver their greenhouse gas targets and other climate and energy commitments.

Therefore, achievements of the ESR goals are closely linked with the effective planning and implementation of the NECPs. Countries must revise their current NECPs - to reflect the ‘Fit for 55’ ambition - and submit a final new NECPs by June 2024.

c) Land Use, Land Use Change and Forestry (LULUCF) Regulation

The final agreement on the revision of the Land Use, Land Use Change and Forestry (LULUCF) Regulation was reached in November 2022. In the trilogues the European Parliament managed to uphold its position against the worst efforts by the Council, but the final agreed Regulation includes muddled transparency due to a complex and difficult text, and a number of accounting loopholes and flexibilities that both will undermine the Regulation’s effectiveness and integrity.

As a whole, the final text outlines a significant improvement to the current LULUCF rules, establishing a more ambitious EU-target and stating targets for the Member States. It is also prominent in acknowledging the linkage and synergies between climate and biodiversity. Nevertheless, the ambition proposed falls short of the necessity that a climate emergency demands and it is nearly half of the commitment suggested by civil society organisations based on scientific evidence.

The amount of flexibilities and loopholes put at risk the validity and reliability of the -310 MtCO₂e. EU-wide removal target, potentially leaving the target as a paper target. Furthermore, it still does not encompass the full potential of carbon sinks in Europe when taking into account

nature restoration pledges. The Regulation does not sufficiently guarantee that the current forest degradation in Europe is reversed and that forests be part of a climate solution to achieve climate neutrality.

This briefing examines the changes brought by this new regulation, shedding light on targets and flexibilities to assess whether the agreed 2030-EU target will work in reality or merely on paper, and if the regulation is in line with climate and biodiversity objectives.

Targets

The Regulation outlines EU-wide and national targets. It sets an absolute and EU-wide net greenhouse gas removal target for 2030 at -310 million tonnes (Mt)CO₂eq. This new EU-level target is both an increase from the current -260 Mt level, and from what the current legislation would have allowed the sink to decrease by 2030 (-225 Mt). Although the target is timid and does not seize the potential of restoration practices enhancing carbon sinks [advocated by NGOs](#), it is an improvement. It is the first time that the principle that Member States should increase their sinks is adopted.

Our analysis however reveals that the true atmospheric achievement of the -310 Mt in 2030 is **uncertain given the flexibilities and the relative national targets** (see below), having the potential to decrease up to -290 Mt.

The Regulation establishes **relative binding national targets** for 2030. While both the Commission and the Parliament defended absolute Member States targets, the Council weakened the proposals and pushed for the inclusion of relative targets, based on reported net removals data from 2016-2018 that can still be adjusted by Member States (MS can change how they calculate emissions in the greenhouse gas inventory and can suggest their target changes accordingly). This brings a high level of uncertainty as to whether the EU-wide -310Mt, which represents the sum of national targets, will be reached.

To ensure progress towards the achievement of these national targets, the Regulation provides for an emission budget system based on individual linear trajectories ending in 2030 that Member States will have to follow.

Another **national commitment** is outlined in Article 4(4) for the years 2026-2029 to ensure that the Member States are on track to meet their target in 2030. This is a non-binding commitment that essentially compares Member States greenhouse gas annual data with yearly 'limit values' so-called Member States **budgets**. The Member States budget is defined by the difference between the annual greenhouse gas limit established in the linear trajectory and the average value for its greenhouse gas inventory data for the years 2021, 2022 and 2023, as submitted in 2025. The linear trajectory is yet to be adopted by the Commission via implementing acts.

The compliance check to judge if a country's carbon sink was lower than the budget set for that period, will take place in 2032. If a country had a lower sink than allowed in their budget, a country must use flexibilities to comply (Article 12, para 2).

All in all, it is positive that the regulation sets binding targets for Member States for 2030 and a budget (2026-2029) with consequences stated in case of no compliance (Article 13c). Nevertheless, the room for methodological changes in the greenhouse gas inventories, and,

consequently, in the Member States' relative targets, is concerning. The Commission promises to overcome this hurdle by reviewing any big discrepancy in the Member States' inventories.

Accounting rules

This revision changes only the accounting rules for the period of 2026-2030. The former LULUCF rules (i.e. 'no-debit' rule and 'Forest Reference Levels'¹⁵ system) will remain applicable until 2025.

The major improvement to the accounting rules is the abandonment of the extremely complicated 'forest reference levels' accounting system from 2026 onwards. This system will be replaced by a much simpler system based on reported emissions. Measuring greenhouse gas inventories instead of comparing data to a constructed baseline is a very important positive change that increases clarity and transparency, but unfortunately the same clarity is not maintained in the text presenting national targets and budgets.

The accounting in wetlands will start in 2026 according to Article 2(2) unless a Member State notified the Commission of its intention to include wetlands in the scope of its commitments for 2021-2025 (Article 4(1)).

In a positive note, the final text does not include the Commission's proposal to enlarge the **Harvested Wood Products category** by including additional "carbon storage products". This could have been a very big accounting loophole. However, although left out of the LULUCF regulation it could potentially become a part of the upcoming Carbon Removal Certification Framework.

Flexibilities

As in the previous version of the LULUCF Regulation, Member States benefit from a large number of 'flexibilities' (i.e. offsetting) to meet their 'no-debit' target until 2025 and their national target from 2026 onwards. These flexibilities risk undermining the integrity of the system and ultimately decrease the EU-wide target.

In the first period (2021-2025), article 12 lays out the general conditions around flexibilities over both compliance periods and says that countries that overachieve their target can sell their surplus to other countries as long as double counting is avoided. Furthermore, the Managed Forest Flexibility (article 13) gives a flexibility of up to 178MtCO₂e to Member States meeting their 'non-debit' rule in 2025 and article 13a brings an extra compensation to Finland.

For the second period (2026-2030), as a general flexibility, article 13b states that up to 178 MtCO₂e is made available to compensate countries that do not meet their targets provided the overall 2030 is reached.

¹⁵ Forest Reference Levels (FRLs) are projected benchmarks to account the sum of greenhouse gas emissions and removals from forest lands in each Member State. These projected FRLs are then compared with the actual sink. The former LULUCF rules failed to provide full transparency on how these constructed future baseline (i.e. FRLs) would be established, and therefore was criticised by civil society organisations. See: [Position Paper on the revision of the EU LULUCF Regulation - CAN Europe](#)

Natural disturbances flexibility and EU-wide target

For the period 2021-2025, the regulation gives Member States the possibility to exclude greenhouse gas emissions resulting from natural disturbances in the greenhouse gas accounts if they exceed the average emissions caused by natural disturbances in the period 2001-2020.

The Regulation does provide for caveats according to which emissions from salvage logging and prescribed burning cannot be excluded.

Natural disturbances also come into play from 2026 onwards. For the second period (2026-2030), article 13b creates the possibility of transferring, an additional loophole in which the Commission shall include up to 20 MtCO_{2e} of unused surplus from 2021-2025 provided that Member State submitted evidence of natural disturbances. This means that the EU-wide target of -310 MtCO_{2e} can be reduced to **-290 MtCO_{2e}** which is not a lot higher than the current -260 MtCO_{2e} level.

The impact of natural disturbances which can be exacerbated by poor management choices and climate change should be tracked and not be subject to additional flexibilities.

Other flexibilities such as the use of surplus from another Member State in case of natural disturbance (article 13b(5)) and extra 50 MtCO_{2e} compensation throughout the decade in case of long-term impacts of climate change or high level of organic soils (article 13b(6)) are specific for Member States' targets and would only take place if the EU-wide goal of -310 MtCO_{2e} (-290MtCO_{2e} in the worst case scenario) has been reached.

Governance and Penalties

Article 17 outlines measures that are aimed to ensure the -310 MtCO_{2e} by 2030 will be reached, with reviews and potentially additional proposals for measures from the Commission. Other positive caveats are the calculation and publication of the impact of flexibilities. To ensure robust methodological adjustments, the Commission will review and verify transparency, consistency and comparability of any change in inventory data reported by Member States that is greater than 500 KtCO_{2e}.

Mirroring the governance provisions from the Effort Sharing Regulation, the LULUCF Regulation now provides a compliance factor (Article 13c). If a Member States overshoots their budget (see above), then the 2030 target becomes more stringent. After having used its flexibilities, additional greenhouse gas removals will be added on top of the country's 2030 target. Underperformance is discouraged through this mechanism, but not prohibited.

Regrettably, the Regulation does not go further, and does not provide for any penalties if Member States targets are not met, despite the current alarming decline of several Member States' sinks.

AFOLU pillar after 2030

The NGO community welcomes the rejection of an AFOLU (Agriculture, Forestry and Other Land Use) pillar and climate neutrality target by 2035 for such a pillar, by both the Parliament and the Council. This will avoid bringing together the LULUCF sector with the non-CO2 agriculture emissions and giving the possibility to the agriculture sector to hide a large part of its emissions behind the LULUCF sector, reducing incentives for them to be decreased. However, the final Regulation text includes a request to the European Commission to prepare an impact assessment on how to reduce agriculture sector's emissions and whether or not an AFOLU pillar is a suitable solution.

Biodiversity

Article 14 creates an obligation to Member States to produce a compliance report to ensure: (i) synergies and concrete links between the LULUCF sector and the EU's biodiversity strategy, and (ii) that DNSH principle is taken into account in national policies and measures. Following much advocacy from green groups, the final text also includes the acknowledgement and good wording in recitals 2 and 5 regarding biodiversity and the Do No Significant Harm principle (DNSH) respectively.

Therefore, the final text shows that the LULUCF Regulation goes beyond an accounting framework, taking into account interlinkages between the climate and biodiversity crisis and has a legal obligation to observe synergies with the EU's Biodiversity-, Soil-, and Forest Strategies. The LULUCF targets could also benefit from a strong nature restoration regulation.

CONCLUSION

The revision of the EU's key climate policy framework comes at a crucial time when global temperatures are hitting record levels and increased, immediate and bold action is indispensable to keep the 1.5°C target alive. Europe takes a key role in stepping up and acting in line with its fair share to the global challenge. For the EU this means maintaining pressure on ramping up emission cuts in the short term and substantially moving beyond the insufficient net -55-57 emission reductions by 2030.

It is now vital that the EU adopts climate emergency measures that will enable the EU to reach at least -65% emission reductions by 2030. At the same time, Member States need to use the NECP process to move beyond their legally binding commitments when implementing the 2030 climate framework. And the process around setting a 2040 EU climate target and indicative and equitable greenhouse gas budget for the EU needs to spur increased action in the near term and alignment to achieve EU-wide net zero emissions by 2040 at the latest.

CONTACTS

Klaus Röhrig

Head of Climate, lead on EU Emissions Trading System (ETS)
klaus.roehrig@caneurope.org

Brigitta Bozso

Climate Policy Coordinator, lead on Effort Sharing Regulation (ESR)
brigitta.bozso@caneurope.org

Erich de Castro Dias

Land Use & Climate Policy Officer, lead on LULUCF Regulation
erich.castro@caneurope.org

www.caneurope.org info@caneurope.org

[Facebook](#) [LinkedIn](#) [Twitter](#) [Podcast](#)