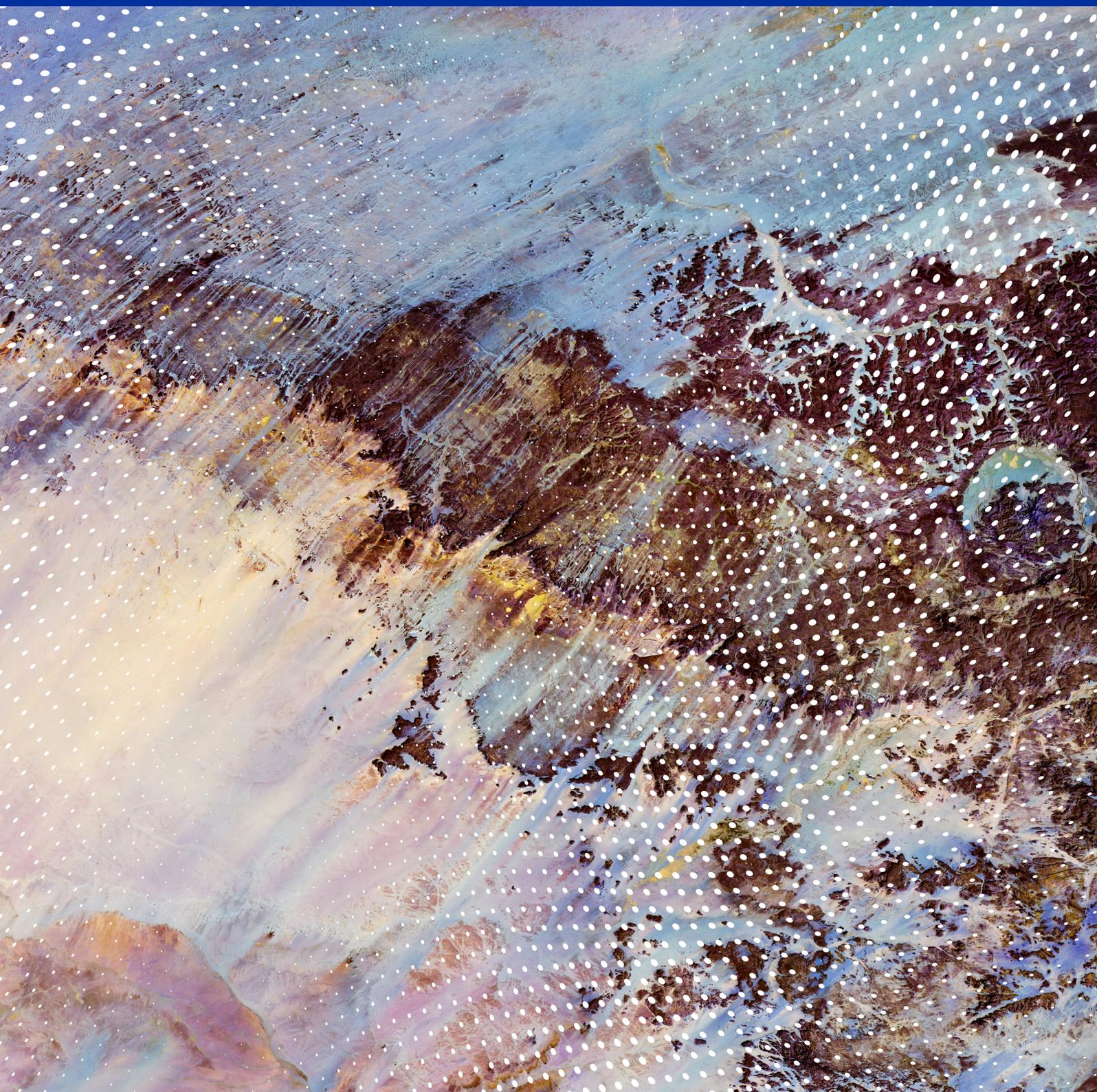


Advocating for Fair and Effective Carbon Pricing at National Level

LifeETX Guide



LIFE ETX

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Written by Eleanor Scott, Policy Expert on EU Carbon Markets

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The information and views set out in this report are those of the author(s) and do not necessarily reflect the official opinion of the European Commission.

FURTHER INFORMATION

Eleanor Scott, Policy Expert on EU Carbon Markets
eleanor.scott@carbonmarketwatch.org

Gemma Bowcock, Project Manager at Carbon Market Watch
gemma.bowcock@carbonmarketwatch.org



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EXECUTIVE SUMMARY

On 16 May 2023 the Official Journal of the European Union published the revision of the EU ETS as part of the 'Fit for 55' package to align the ETS with the EU's 2030 aim to reduce greenhouse gas emissions by 55%. More recently, the European Commission announced on 6 Feb 2024, its recommendation for the EU's 2040 climate target; a 90% net reduction in greenhouse gas emissions compared to 1990 levels with an aim to achieve 'net-zero by 2050'. This ambition is a full 10% under the net zero that the EU should achieve by 2040 if it is to contribute its [equitable share of global climate efforts](#).

This report investigates the impact of the revision in its initial stages at national level and highlights areas for intervention and improvement. National advocates can play a major role in helping the EU ETS to deliver its emissions reductions targets. However, they must be equipped with the right information, and given support to properly mobilise.

To improve the environmental impact and equity of the EU ETS, this guide identifies 10 key messages for member state level advocacy:

1. Align the EU ETS with the 2040 climate target, and increase the rate of emission reductions
2. Make the polluter pay! Speed up the phase out of free allocation of emission allowances to energy intensive industries
3. To protect member state revenue the ETS price must remain high enough to trigger emissions reductions - strengthen the market stability reserve!
4. Expand the ETS to full scope for both aviation and shipping and include non-CO₂ impacts for aviation
5. Carbon pricing alone can not deliver emissions reductions in buildings and transport. Complementary policies are needed to ensure access and affordability of emissions reductions especially for lower income groups
6. To make the spending of the Social Climate Fund (SCF) effective, member states must ensure systematic consultation with civil society to effectively target support for lower income and vulnerable groups within the National Social Climate Plan process
7. Include stricter criteria for spending ETS revenues to ensure that member states support climate action and the just transition, mobilising ETS2 revenue to target support for emissions reductions in buildings and road transport beyond the SCF
8. Remove the additional emission allowances that may enter the market from the decommissioning of coal-fired plants in member states
9. Ensure no more funding of fossil fuel projects under the Modernisation Fund or Social Climate Fund
10. Divert subsidies for fossil fuels and industrial pollution to fund climate action

KEY RECOMMENDATIONS FOR NATIONAL ADVOCACY

1. Align the EU ETS with the 2040 climate target, and increase the rate of emission reductions

The European Union's Emission Trading System (EU ETS) is a market-based mechanism with the purpose of reducing greenhouse gas emissions. It is a key instrument in the EU's efforts to combat climate change and achieve its emissions reduction targets. The main goal of the EU ETS is to encourage industries to reduce their emissions efficiently by setting a cap on the total amount of greenhouse gases emitted by covered installations. The EU ETS applies the 'polluter pays principle', meaning that the cost of pollution should be borne by polluters. The EU ETS is cross-sectional, covering electricity and heat generation, energy intensive industries, aviation and shipping (from 2024). Fuel used in buildings and road transport (from 2027) will be monitored under the newly created ETS2.

The ETS revision increases the EU's climate ambition: with the introduction of ETS2 roughly 75% of the EU's emissions will be covered by carbon pricing. The 2030 target for emissions reductions within sectors covered by the EU ETS has also been raised from 43% to 62% compared to their 2005 level.

While this might be compatible with achieving net reductions of 55% by 2030, [environmental NGOs](#) demand net reductions of 76% by 2030 to ensure that the EU contributes its fair share of emissions reductions as agreed within the Paris agreement. This means that reductions in the sectors covered by EU ETS should at least be [reduced by 70% by 2030](#), compared to 2005 levels.

This ambition gap is also present in the new 2040 target. The [European Scientific Advisory Body on Climate Change](#) states that 90% net emissions reductions by 2040 (compared to 1990 levels) is the absolute minimum level of acceptable emissions reductions to maintain hope of remaining within 1.5 degrees of planetary warming. Increased ambition of [net zero by 2040](#) would allow for a much greater chance of minimising the worst effects of climate change.

The EU ETS needs to fulfil its aim of reducing emissions at a rate that reflects the severity of the climate crisis. National advocacy encouraging member states to show support for an ambitious 2040 climate target will be essential to ensure the ambition of a 90% gross reduction of emissions is upheld. Once the 2040 target is confirmed, the 2026 revision of the ETS will be the prime opportunity to re-align ETS1 and ETS2 so that it can deliver the necessary emissions reductions.

2. Make the polluter pay! Speed up the phase out of the free allocation of emission allowances to energy intensive industries

The aim of the ETSI is to ensure the cost-effective reduction of emissions from the power sector and energy-intensive industries, as well as aviation and shipping. The latest review sets the emissions reductions in [ETSI sectors to 62% by 2030 compared to 2005 levels](#). While this increased ambition is welcome, the persistent issue of free allowances handed out to industrial polluters has long reduced the efficacy of the market, misdirecting public and private finance and decreasing the incentive for polluters to clean up their act.

As a recent Carbon Market Watch report, [The Emissions Aristocracy](#) highlights, over 5 billion in free allowances equivalent to the value of €400 billion will be doled out between 2021-2030, with steel giant ArcelorMittal receiving €3.7 billion in 2022 alone. These are important forgone revenues that could be used to reduce the [climate investment deficit](#). The EU often justifies the practice of free allocation with the '[phantom](#)' threat of carbon leakage, while in reality the risk of industrial players moving operations abroad [cannot be directly attributed](#) to carbon pricing policy efforts to reduce emissions.

The issue of free allowances has also been partially tackled in the latest revision: their phase out is foreseen by 2030, but certain heavily polluting sectors have been granted an exemption to continue for a few years beyond then. The ETS revision introduced the Carbon Border Adjustment Mechanism (CBAM), to ensure a level-playing field of certain products among EU and extra-EU producers. From 2026 importers of cement, aluminium, fertiliser, electricity, hydrogen, iron and steel will be required to surrender newly created CBAM certificates equivalent to the emissions of their products. Free allowances in these sectors will not be fully phased out until 2034.

As it currently stands, CBAM is not ambitious enough. The slow cancellation of free pollution permits weakens the carbon price signal and ensures that heavy industries continue to receive handouts. Given the huge economic value that free allocation still holds it's essential that free allowance allocation is strict and constantly improved. As foreseen in the latest revision, and laid out in the updated Free Allocation Regulation (FAR), the allocation of free allowances to industry should remain fully conditional on both energy efficiency audits and the establishment of ambitious decarbonisation plans at installation level. Worst performers should not be granted any free allowances if they [fail to fulfil all requirements](#).

The below figures illustrate the amount of allowances auctioned per member state and those freely allocated in 2024. The accompanying table highlights the expected foregone revenue through free allocation per member state (in €

million, based on an average EUA price in 2023 of €80).

Figure 1.

Estimated allowances to be auctioned or freely allocated in 2024
in million EUAs

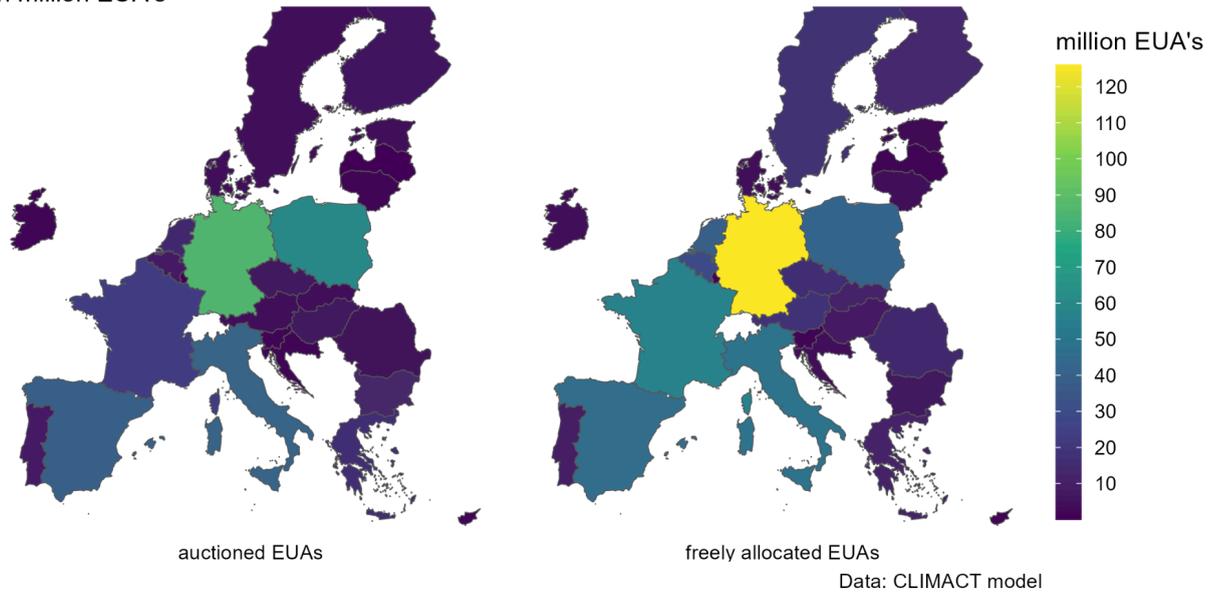


Table 1. Expected foregone revenue through free allocation per member state (in € million, based on a EUA price of 80 EUR)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Total	43976	43976	43976	43975	43975	37548	35854	33562	29825	25126
Germany	10076	10076	10075	10075	10075	8582	8179	7633	6744	5624
France	4474	4474	4474	4474	4473	3792	3612	3367	2969	2469
Italy	3828	3827	3827	3827	3827	3281	3147	2965	2668	2296
Spain	3679	3678	3679	3679	3679	3153	3022	2845	2556	2192
Poland	3426	3425	3424	3423	3422	2900	2775	2602	2322	1971
Netherlands	3125	3127	3129	3131	3134	2654	2530	2366	2095	1754
Belgium	2313	2315	2316	2318	2319	1966	1867	1736	1520	1248
Austria	1474	1474	1474	1474	1474	1273	1208	1122	981	803
Sweden	1383	1382	1381	1380	1379	1150	1107	1045	947	824
Czech Republic	1239	1239	1239	1239	1239	1060	1006	933	814	664
Romania	1142	1142	1142	1142	1142	1006	952	879	760	609
Finland	1043	1042	1041	1040	1039	851	827	790	732	661
Norway	1012	1013	1013	1014	1014	870	837	793	721	630
Slovakia	923	924	924	924	925	807	763	705	609	489
Greece	868	868	868	869	869	780	748	705	634	545
Portugal	684	683	683	683	683	595	570	535	480	409
Hungary	667	667	668	668	668	572	544	506	444	366
Bulgaria	546	545	545	544	543	449	437	418	389	353
Denmark	392	392	391	391	391	330	321	307	285	258
Lithuania	357	357	357	357	357	316	301	283	252	213
Ireland	312	312	312	312	312	277	261	241	208	166
Croatia	285	285	285	285	285	255	241	223	193	155
Estonia	204	203	203	203	203	167	166	165	164	163
Iceland	137	137	137	137	137	120	112	101	84	62
Slovenia	109	109	109	109	109	93	88	82	72	59
Cyprus	96	96	96	96	96	90	84	76	63	46
Luxembourg	92	92	92	92	92	81	76	70	60	48
Latvia	89	89	89	89	89	78	74	69	59	48

3. To protect member state revenue the ETS price must remain high enough to trigger emissions reductions - strengthen the market stability reserve!

The latest update to the legislation strengthens both the Market Stability Reserve (MSR) and the Linear Reduction Factor (LRF), boosting the ambition of the EU ETS. The MSR is a supply control mechanism that can limit the number of emission allowances or EUAs in circulation on the EU ETS market. It was introduced as a result of chronic oversupply issues that have plagued the ETS since its inception. Since 2019 allowances are transferred from the auction to the reserve whenever the total number of allowances in circulation (TNAC) is higher than 833 million. When the TNAC is lower than 400 million, the MSR releases 100 million allowances. Due to the latest revision, the MSR will be strengthened by maintaining the annual allowance intake rate at 24% of the TNAC until 2030. Furthermore, the agreement will restrict the number of allowances that can be held in the reserve to 400 million, with any surplus being permanently cancelled.

As the totals of the Modernisation Fund and Innovation Fund are calculated based on an EUA price of €75 a tonne, there is an imperative to ensure that the supply of EUAs adjusts in response to issues of oversupply to ensure adequate climate finance.

Strengthening the MSR is vital considering EU ETS price fluctuations since the start of 2024, in which prices decreased from €84 per tonne to lows of €52. The MSR protects against an oversupply of allowances as a result of lower demand for pollution permits following economic downturn or the growth of renewables in the energy mix. A high carbon price sends a strong signal for investment in emission reductions and increases member states ETS revenue to fund climate action. CMW recommends maintaining (or strengthening) the 24% withdrawal rate of the market stability reserve, in order to avoid the re-emergence of an oversupply of allowances on the market.

4. Expand to full scope the ETS for both aviation and shipping and include non-CO² impacts for aviation

The ETS has been expanded to include the maritime sector, accounting for around 2-3% of greenhouse gas emissions. 100% of emissions for voyages departing from and arriving at a port under the jurisdiction of an EU member state will be included, as well as 50% of emissions on voyages where one leg of the journey begins or ends in the EU and the other in a non-EU country.

Phase-in begins in 2024 with shipping companies required to pay for 100% of their emissions for certain ships from 2027. The EU ETS will apply to all cargo and passenger ships of 5,000 gross tonnage (GT) and above. In 2027, the EU will decide on whether to expand the scope of the ETS to include offshore ships of 5,000 GT and above, and general cargo ships ranging between 400 GT and 5,000 GT. The EU ETS for shipping will cover all carbon dioxide (CO₂) emissions from 2024 and all methane (CH₄) emissions and nitrous oxide (N₂O) emissions from 2026. There are some exemptions; no fishing vessels, private yachts, service vessels or military vessels will have to pay for their emissions.

As [Transport and Environment highlights](#), the ETS price is unlikely to become high enough to trigger the decarbonisation of ships across Europe as the price difference between carbon and renewable fuels is too great; additional complementary legislative measures will be needed. The extensive list of exemptions, as well as the total exemption of ships below 5,000 GT, means that many emissions are excluded from scope and will totally avoid paying for their pollution.

Flying is the most carbon-intensive form of transport. While flights temporarily stalled during the pandemic, emissions growth has since returned with 6.7 million flights taking off in 2023, resulting in a 13.2% growth in emissions compared to 2022. Implementing the polluter pays principle is particularly important given the climate impact of flying. However, this is complicated by the global nature of aviation and cross-jurisdictional considerations.

When aviation was initially brought into the EU Emissions Trading System in 2012, the idea was to include all flights departing from or arriving at an airport in the European Economic Area (EEA). However, following considerable pressure from industry and third countries like the US and China, the EU decided to temporarily reduce the scope to cover only intra-EEA flights, in what is referred to as a 'stop the clock' measure. Regrettably, the latest revision decided to maintain the 'stop the clock' procedure until at least the start of 2027. By extending the 'stop the clock' measure, the majority of Europe's aviation CO₂ emissions, which are emitted by flights to and from other parts of the world, will remain unaccounted for.

Member states voted against expanding the scope. Instead, they decided to use the unambitious and weak system agreed on at the international level — the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA), developed by the International Civil Aviation Organisation (ICAO) — to address international aviation’s emissions. To fully address the climate impact of the aviation sector’s CO₂ emissions, we urgently need coverage of all flights leaving and entering the EU.

A positive improvement in the revision is that free allowances given to airlines will be gradually eliminated. Airlines will receive 25% fewer free allowances in 2024 and 50% fewer in 2025. They will pay for the entirety of their emissions within the EU starting from 2026. This means that, at long last, the aviation industry has a greater obligation to cover the costs of its carbon footprint, which, as a consequence, fosters stronger emission reductions. This incentive can be further boosted by removing the derogation of excise duty for aviation fuel.

In response to a lack of progress in ensuring effective and fair carbon pricing for aviation and shipping at the global level through industry self-regulation, we call for full-scope expansion of the ETS for both aviation and shipping, meaning all greenhouse gas emissions from incoming and outgoing extra-EU flights and ship voyages are covered. For the aviation sector, we recommend the full inclusion in the EU ETS of non-CO₂ impacts, such as nitrogen oxides and contrails.

5. Carbon pricing alone can not deliver emissions reductions in buildings and transport. Complementary policies are needed to ensure affordability of emissions reductions especially for lower income groups

After prolonged inter-institutional negotiations it was decided to extend the ETS to cover emissions from fuel used in buildings and road transport from 2027, with the creation of an adjacent but separate Emission Trading System for fuel suppliers, called “ETS2”. Achieving net zero by 2050 will not be possible without deep renovations across the EU’s building stock, and increasing renewable energy coverage to buildings and road transport. Following limited progress to date, the ETS2 will be a valuable tool in expediting the lagging rate of emissions reductions

in the buildings and road transport sectors. However the implementation of ETS2 must be paired with robust and complementary policies that prioritise access and affordability to emissions reductions.

According to the [latest recommendations](#) from the European Scientific Advisory Board on Climate Change the average reduction rate of GHG emissions in the transport sector since 2005 would need to increase more than tenfold to meet the 2030 climate target, and go even further after 2030.

For buildings, the situation is similarly urgent. The renovation rate needs to double as 75% of the EU's buildings are currently classified as energy inefficient, while GHG emissions reductions must triple between 2024-2030 alone. While there are success stories, such as the uptake in heat pumps (3 million installed in 2023) and improvements to emissions standards for vehicles, progress is simply too slow and major barriers such as high upfront costs and a lack of technical support persist.

Once launched, the objective is for a 42% reduction in emissions for buildings and road transport by 2030 compared with 2005 levels. For these sectors, the ETS2 cap will reduce to zero by 2044. From 2027 onwards fuel suppliers will be required to purchase fuel allowances based on the carbon intensity of the fuel sold with the price then passed on to consumers. Safeguards are built-in until 2030 to prevent 'excessively high' carbon prices. The supply of allowances will be front loaded by auctioning an additional 30% in the first year and there will be a soft price ceiling at €45 per tonne, once this price is reached an additional 20 million allowances will enter the market. However, this is not a binding price control and prices are likely to rise above €45 meaning member states need to introduce complementary policies and support well before the launch of the system in 2027 to limit any welfare impact upon lower income people.

As the ETS2 price is levied equally across all member states the Social Climate Fund (SCF) was created to provide €86.7 billion in support to groups considered to be most vulnerable, to offset resulting increases in energy and transport poverty. Beyond the SCF the ETS2 will be a much needed source of emissions mitigation revenue, estimated to raise approximately [€260 Billion between 2026-2032 \(assuming an average price of 45€ a tonne\)](#), 100% of which must be spent on climate action as outlined by the ETS Directive.

Putting a price on the pollution in buildings and transport alone will not deliver the needed emissions reductions. Member states must implement complementary policies to increase the access and affordability of emissions reductions. This can be funded by phasing out fossil fuel subsidies, which usually take the form of tax exemptions or tax reductions, budget transfers, income and price support, and the under-pricing of products at national level. Between 2008 and 2019 EU Member States provided €55 to 58 billion in annual subsidies for

fossil fuels. The energy crisis as a result of the Russian invasion of Ukraine led to increases in tax breaks for fuel producers, with [subsidies rising to EUR 123 billion in 2022](#). While protection from high prices is needed to protect the economically vulnerable, these subsidies were often not targeted or paired with measures to help lower income groups participate in the energy transition. Going forward member states must redirect these funds to expand the supply of renewable energy and electrification, and to provide grants and subsidies for home renovation and heat pump installation, energy efficiency standards, electrical vehicle subsidies and leasing schemes, prioritising low and middle income groups. Combined these actions will lower demand for fossil fuels and reduce the potential exposure of citizens to the ETS2 price.

As a result, the ETS2 could have many co-benefits. By retrofitting our homes we can create jobs and skills, increase our independence from Russian oil and gas imports and enjoy warmer homes. By investing in zero carbon transport we gain an opportunity to boost our economy and make our cities and rural communities more accessible.

The introduction of ETS2 can instigate positive climate action in the EU if carefully implemented and the revenue spent wisely. Correct and proper spending of ETS2 revenue will be essential for building public support, and can deliver a double dividend of reducing emissions and combating energy poverty. Civil society organisations have an important role to play in encouraging their governments to implement complementary policies that ensure the access and affordability of emissions reductions in building and transport sectors.

Current National Energy and Climate Plan (NECP) drafts contain sectoral targets for renovation, heating and cooling that vary in ambition. Generally, plans lack clear detail, without explicit reference to technologies or funding sources. Regarding transport, most member states have announced intentions to increase the electrification of transport and increase the use of public transport. However it is unclear whether stated promises will be enough to align with the EU's 2030 climate target and plans provide little detail in terms of adequately addressing energy and transport poverty. The more effective policies are at reducing dependence on fossil fuels before the introduction of ETS2 the lesser the adverse impact on the carbon price. Therefore it is essential that governments are pressured into ensuring access to affordable emissions reductions schemes now. NECPs are currently being revised with final submission in June 2024.

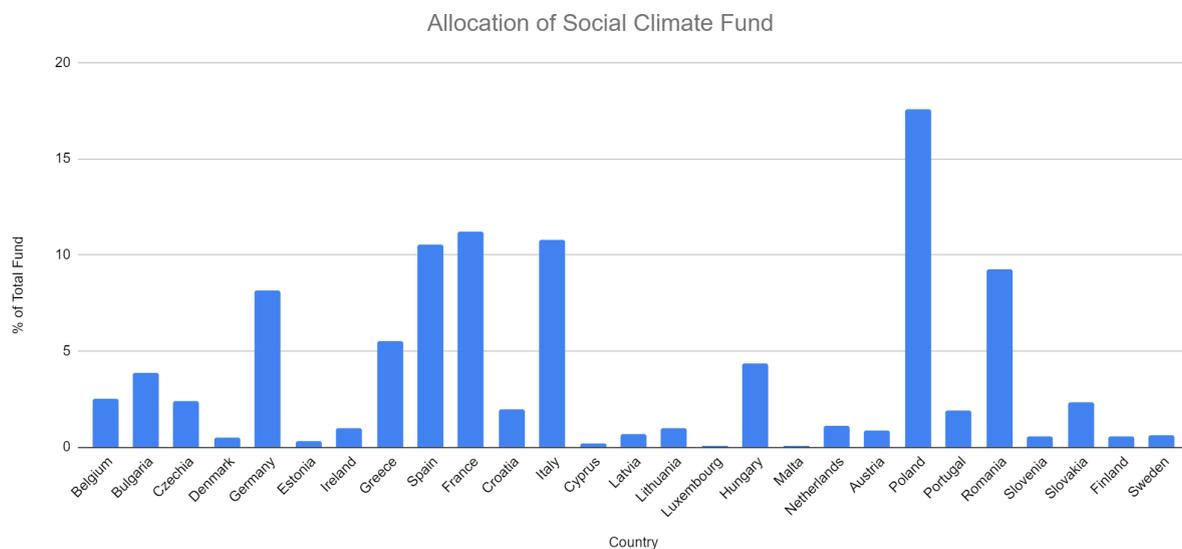
6. To make the spending of the Social Climate Fund (SCF) effective, member states must ensure systematic consultation with civil society to effectively target support for lower income and vulnerable groups within the National Social Climate Plan process

The Social Climate Fund (SCF) was created as a barrier against increases in energy and transport poverty as a result of the introduction of ETS2. The total funding available under the Social Climate Fund is €86.7 billion, including member state co-financing of 25%. Member states will have to submit National Social Climate Plans (NSCPs) before June 2025 in order to access the fund.

The SCF can be spent on green investments to reduce emissions and a limited amount on temporary direct income support (37.5% of the fund) with a further 2.5% available for the provision of technical assistance and capacity building. Green investments can include energy saving renovations, decarbonisation of heating and cooling, low/zero carbon vehicles (the remaining 63% of the total fund).

The fund will be allocated to each member state based on a calculation of need - considering the percentage of the population at risk of poverty in rural areas, CO₂ emissions from fuel in homes, houses at risk of poverty with arrears on utility bills, total population, GNI per capita. The countries that will receive the most funding are Poland (17.6 %) France (11.2 %) Italy (10.8 %) Spain (10.5 %) and Romania (9.3 %).

Figure 5.



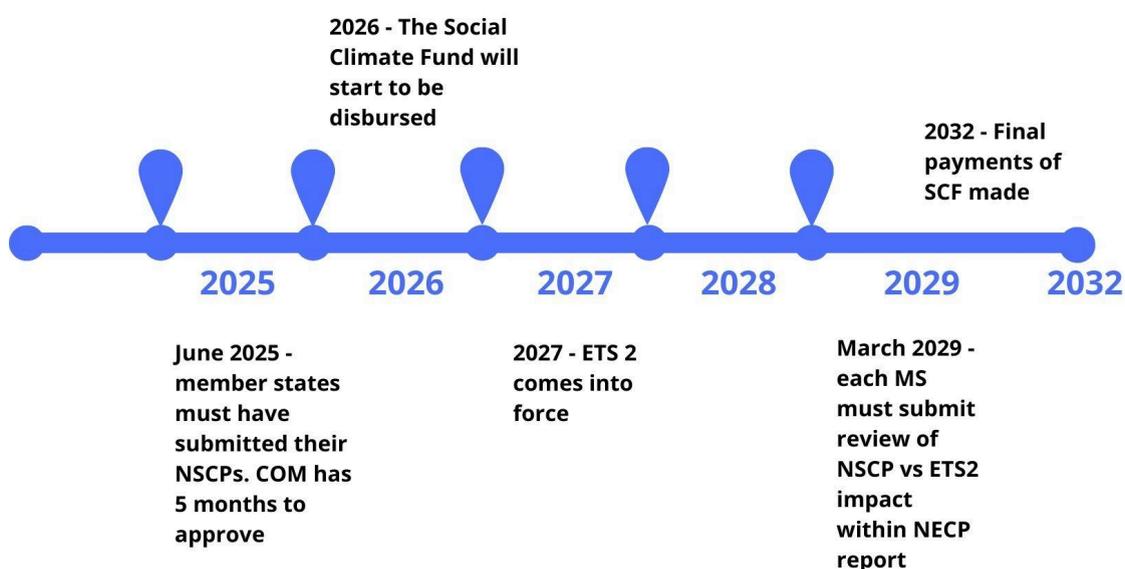
Disappointingly, the size and ambition of the Social Climate Fund has shrunk since the Commission initially proposed that member states pay half of the co-financing for SCF projects, rather than the current 25%. As the total funding of the SCF is not linked to the ETS2 price but rather capped at €86.7 billion, the relative size of the fund compared to ETS2 revenue decreases as the ETS2 price rises. While a soft price ceiling within the ETS2 exists at €45 a tonne, ETS2 prices may exceed this. Support for lower income groups to reduce their dependence on fossil fuels must go beyond the funding of the SCF with the ETS2 revenue also available to fund measures to increase the affordability of emissions reductions in buildings and transport.

To access the SCF each member state must complete a National Social Climate Plan (NSCP) following a mandatory consultation process with stakeholders. In order to ensure that the most vulnerable are protected, the NSCPs must effectively: define eligible groups, locate households and find channels to deliver support to those who meet the agreed EU energy and transport poverty definitions.

While the definitions for energy and transport poverty are defined at EU level, the indicators may shift across nations and regions. Potential indicators include income decile, percentage of income spent on energy, the percentage of the population in the worst energy performing buildings and the percentage of people in a country who rely on biomass fuel, such as wood for heat, which is outside the scope of the ETS2. Member states are obliged to report on the progress in the implementation of their NSCPs within the overall reporting on their National Energy and Climate Plans.

The timeline for the SCF is as below:

Figure 6.



As the NECP process has highlighted, the consultation process within member state planning is often insufficient. Civil society has an important role in providing an on the ground understanding of national and regional circumstances that should be taken into consideration within the NSCPs where a lack of accurate data will be a barrier to delivering targeted support.

Social justice and energy supply are interlinked - 9.3% of people in Europe were unable to adequately heat their homes in 2022. Rethinking our energy supply gives us the chance to solve two problems at once - increase access to renewable energy, and combat energy poverty. CSOs can advocate for measures that maximise climate and social benefit that goes beyond the stipulation of 'do no significant harm' and to 'reduce fossil fuel dependency'. Pressure must be put on member states to deploy policies that increase the supply of renewable energy rather than make existing fossil fuel usage more efficient, for example through the funding of fossil gas boilers. Special consideration must be given to those living in social housing, tenants and lower income groups to avoid a 'two tier transition' in which only the wealthy are able to afford to reduce their emissions and resulting exposure to the ETS2 price. Temporary income support will be needed for the most vulnerable, however measures should also aim to generate an emissions mitigation benefit as lowering dependency on fossil fuels provides an opportunity to decrease energy poverty in the long term.

7. Include stricter criteria for spending ETS revenues to ensure that member states support climate action and the just transition, mobilising ETS2 revenue to target support for emissions reductions in buildings and road transport beyond the SCF

As carbon prices have increased significantly over recent years, so too have revenues from these auctions – with ETS revenues rising from €5 billion in 2017 to €30 billion in 2022. The use of ETS revenue is of political importance as an important aspect of the implementation of the polluter pays principle is the ability to finance policies of climate benefit, creating a double dividend. The continuation of the issuing of free allowances means that over 5 billion allowances, with an estimated market value of €400 billion are to be granted between 2021 and 2030, a waste of funds that not only distorts the incentive for industry to decarbonise, but forgoes potential funding for climate action.

As the EU expects people to pay for the pollution in their homes and vehicles it is only right that industry is not permitted to pollute for free as is the case under the current ETS1 framework, which issues free allowances to energy-intensive sectors like steel, cement and chemicals. In 2022, around €47.6 billion was handed out in free allowances to those sectors – effectively a licence to pollute at no cost and a waste of funds that could be invested into combating energy poverty. This discrepancy in funding becomes even more pressing when we contrast the bounty of €400 billion worth of free allowances for industry from the [Social Climate Fund](#), which is capped at €86.7 billion (the equivalent of 200 million allowances).

An important change in the latest revision is the obligation for member states to earmark 100% of ETS revenues for climate action. This is a big improvement from the previous non-binding recommendation to reserve only half of the revenues. Although the ETS Directive has listed spending areas which can be considered 'climate and energy related purposes', details are vague and rife with loopholes. The EEA recorded that between 2013 and 2020, 75% of revenues were reported as deployed for climate and energy-related purposes across the EU-27, and 76% in 2021 and 2022. However, according to an [investigation by WWF](#), between 2012-2021 at least €12.4 billion of this money allegedly contributing to climate action had in fact an unhelpful or damaging impact on the climate. Funds were spent on: industrial compensation for the ETS carbon price, modernisation of coal infrastructure, transitioning from coal to gas, fossil fuel-based heating systems, diesel cars or high carbon sources of bioenergy. A lack of consistent reporting of data means that it's nearly impossible to verify the quality of the spending on 'climate action.'

Furthermore, member states can declare that new ETS auctioning revenues are used to support already existing climate policies and measures. Spending on these areas does not lead to additional emission reductions, strengthen resilience against the impacts of climate change, or promote the transition to climate neutrality. Member states also risk undermining the effectiveness of the EU's carbon market by reimbursing companies for the ETS price through industry compensation schemes. Revenues would be better spent if they were transparently channelled towards specific and additional climate projects, and available funding could be significantly raised by abolishing the free allocation of EUAs. As the ETS is due to generate peak auctioning revenue in the coming years an improvement to the definition is urgently needed. Wise spending of ETS1 and ETS2 revenue will go a long way in ensuring a just transition and support for climate policy.

Table 2. Expected ETS revenue per member state per year (in € million, based on a EUA price of 80 €/tCO₂e)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Total	34995	30268	32897	29507	29092	27354	24476	25330	24799	20961
Germany	8037	6887	7560	6873	6835	6500	5855	6135	6073	5193
Poland	5650	5094	5324	4788	4653	4348	3946	3943	3791	3284
Italy	3794	3251	3569	3244	3226	3068	2764	2896	2867	2451
Spain	3717	3259	3499	3166	3116	2940	2657	2728	2667	2293
France	2197	1883	2067	1879	1869	1777	1601	1677	1661	1420
Greece	1520	1340	1431	1294	1270	1196	1082	1105	1077	927
Netherlands	1345	1153	1265	1150	1144	1088	980	1027	1016	869
Bulgaria	1215	1105	1145	1028	994	926	841	832	795	691
Belgium	803	671	748	669	665	626	552	584	577	475
Portugal	767	675	722	653	641	604	546	559	545	469
Czech Republic	753	568	705	544	536	462	346	393	379	220
Hungary	638	570	601	542	529	496	449	453	439	379
Romania	628	475	587	421	403	323	216	242	217	74
Finland	616	520	576	519	516	488	434	457	452	378
Austria	467	388	434	387	384	361	316	335	331	270
Denmark	438	366	408	365	363	342	302	319	315	260
Slovakia	381	322	358	300	292	263	222	229	219	165
Estonia	374	338	353	317	308	287	261	260	250	217
Sweden	326	279	307	279	277	264	237	249	246	211
Norway	270	226	252	225	224	211	186	197	194	160
Ireland	223	169	201	169	167	151	121	134	131	90
Slovenia	196	174	185	167	164	154	139	142	138	119
Croatia	161	139	151	133	130	121	106	110	106	87
Cyprus	116	103	109	99	97	91	82	84	81	70
Lithuania	113	97	106	90	87	79	67	69	65	51
Latvia	92	84	86	78	75	70	63	63	60	52
UK - Northern Ireland	89	76	83	76	75	72	65	68	67	57
Malta	44	39	41	37	36	34	31	31	30	26
Iceland	13	10	12	10	10	10	8	9	9	7
Luxemburg	12	5	9	5	5	3	0	1	1	0

While EU member states should be free to decide the climate actions they devote ETS revenue to, stricter criteria should be put in place to avoid the misuse of resources to further procure and upkeep fossil fuel infrastructure. To better track how ETS revenues are spent and to compare how member states use this income, more transparent reporting is needed.

At member state level, CSOs can analyse available information related to government spending to determine if their governments are upholding their responsibility to devote ETS revenue for climate benefit and to call for increased transparency.

For the ETS2 to serve its purpose of reducing emissions and deliver fair and effective climate action, spending of its revenue must be closely observed. As all fossil fuel subsidies distort the pollution price signal, pressure should be put on member states to redirect this support towards closing the climate investment gap.

8. Remove the additional allowances that may enter the market from the decommissioning of coal-fired plants in member states

[16 member states](#) have taken the welcome decision to phase out coal powered plants by 2040. The closure of coal facilities brings a clear climate benefit, however it creates the risk of an unintended consequence of the ETS market becoming flooded with excess pollution permits, in turn lowering prices and the incentive for actors to cut their emissions.

The decommissioning of coal fired plants will have a considerable social impact. Coal-reliant communities and workers must be supported financially, and re-trained where needed during this transition. To ensure a climate benefit, member states have the option to take these additional allowances out of circulation or return them to auction and preserve this source of revenue. In the case of the latter the [Market Stability reserve alone will not do enough](#) to reduce the supply of emissions allowances. Additional measures will therefore be needed to ensure prices remain high enough to trigger mitigation.

In early 2024, the German government set a positive precedent when it [announced](#) that it [had taken allowances freed up from the closure of coal plants during 2021 and 2022 off the market](#), placing them in the MSR for eventual deletion. Using 2021 as an example, the deletion of allowances for this year would have foregone an [estimated €9.6 billion in revenue](#) for 118 million tons of CO_{2e} but prevented equivalent climate damage of up to €23.3 billion.

CSOs should increase pressure on national governments to first of all adopt a coal phase-out plan if they have not done so already. Secondly, freed up allowances from coal phase outs should be permanently removed, in order to avoid a [waterbed-effect](#), where the closure of a plant leads to an increase in emissions in another region due to the freeing up of allowances that are then used by other polluting activities.

The EU ETS directive itself states that “in the event of closure of electricity generation capacity [...] Member States may cancel allowances, and are strongly encouraged to do so” (article 12.4). [This map](#) by Beyond Fossil Fuels provides a timeline of Europe wide phase-out plans and can be used as a starting point for transnational action. CSOs should encourage Member States to commit to cancelling allowances when power plants are being shut down.

Additionally, the scope of article 12.4 of the ETS directive should be broadened to all sectors covered by the EU ETS, and not only to electricity generation. This would give member states the option to cancel allowances in any case where an ETS installation is being shut down and additional EUAs would be released on the market as a result, ensuring that the closure of polluting installations results in less pollution overall.

Recently, Netherlands based organisation WISE [established a strong campaign](#) to put pressure on the Dutch government to cancel the EUAs from the closure of Dutch coal plants. This campaign provides lessons as to how best to pressure other member states to move beyond the EU’s ‘encouragement’ of the cancellation of these allowances to concrete climate action.

9. Ensure no more funding of fossil fuel projects under the Modernisation Fund or Social Climate Fund

Total revenues of the Modernisation Fund are estimated at €57 billion from 2021-2030, 2% of total EU ETS allowances, assuming a price of €75. The ETS revision resulted in the extension of the Modernisation Fund to Portugal, Greece and Slovenia from 2024 bringing the total number of eligible countries to 13 including; Bulgaria, Czechia, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.

Under the Modernisation Fund investments can be made to expand energy networks, support lower income households to address energy poverty and fund the just transition in carbon dependent regions. The majority of Modernisation Fund resources (at least 80%) must be invested in priority areas such as the generation and use of electricity from renewable sources, the reduction of overall energy use through energy efficiency, energy storage and modernisation of energy networks including district heating pipelines, grids for electricity transmission, and zero-emission mobility.

Outside of these criteria, investments are considered to be 'non priority' and the Modernisation Fund covers a maximum 70% of such costs. The Modernisation fund [claims](#) to provide no support to investments related to energy generation based on fossil fuels 'with some exceptions.' However, in their role as assessor of the proposed projects, the European Investment Bank has not upheld its role as ['Europe's Climate Bank'](#) assigning over €1 billion for gas projects.

As Bankwatch highlights, these [investments](#) are mostly coal-to-gas conversions for combined heat and power stations, but also for a gas pipeline in Romania, power plants, and varied industrial uses. Switching from coal to gas is to replace one polluting fuel with another. With the climate crisis escalating dramatically, EU funds should contribute to climate action, not undermine it. These installations are likely to operate for the next 30-40 years, well beyond the EU's commitment to climate neutrality. Any fossil gas project enabled by EU funds necessarily comes at the expense of investments in renewable energy and energy efficiency that are desperately needed if we are to have a hope of staying within 1.5 degrees of warming.

In member states covered by the Modernisation Fund, CSOs can highlight potential misuse of public funds and call for increased transparency. Civil society often has no chance to comment or oppose proposals that increase fossil fuel investment before the proposals are sent to the EIB for appraisal, creating an unacceptable accountability vacuum. EIB and the member states must acknowledge that further investment in fossil fuels does not align with a future within 1.5 degrees of warming.

10. Divert subsidies for fossil fuels and industrial pollution to fund climate action

[The European Commission acknowledges that EUR 185 trillion is required to deliver Net Zero by 2050](#), at least a three fold increase of current climate finance. Despite this vast need, funds continue to be misdirected through fossil fuel subsidies and inefficient spending. The EU's 8th Environmental Action Programme in 2022 called for the immediate phase out of fossil fuel subsidies. Since then language around the phase out has been watered down with the EU's impact assessment now calling for a phase out of ['inefficient fossil fuel subsidies that do not address energy poverty or vulnerable groups,' ignoring the need for climate investment to deliver a double dividend of combating energy poverty and reducing fossil fuel investment. If we consider that the continued subsidizing of](#)

[fossil boilers leads not only to the lock in of fossil fuels but raises the risk of a two tier transition in which only those who can afford to lower their emissions avoid the ETS2 price. Research by EEB](#) has highlighted that channelling just half of the annual €3.2 billion fossil heating subsidies paid by Member States to heat pumps can transition Europe to 100% renewable heat by 2040.

Wealthier individuals with higher consumption patterns benefit from fossil fuel subsidies the most as the [richest 10% of those in Europe spend 8x as much on fossil fuels than the poorest 10%](#). The continuation of these subsidies distorts the incentive to make green choices, and will limit the impact of the carbon price signal under ETS2, putting renewable energy and energy efficiency investments at a competitive disadvantage

According to the EEA fossil fuel subsidies averaged €56 billion per year between 2015-2021 across the EU, increasing to €123 billion in 2022 during the energy crisis. Pressure must be increased on national governments to remove subsidies on fossil fuel and channel this money directly into increasing the supply of renewable energy and increasing the access and affordability of emissions reductions.

CLIMACT TOOL

Analysis of the Final Legislation Based on Key National Priorities

As outlined, the outcome of the legislation has several impacts for member states: overall emission reductions under the EU ETS, the volume of the allowances distributed to each country, the corresponding revenues (i.e. the member state revenues, the Modernisation Fund and the Innovation Fund) and the speed of the phase out of free allowances offered to the industrial sectors, along with integrating the new Carbon Border Adjustment Mechanism (CBAM).

Carbon Market Watch collaborated in creating a model with Climact to analyse the differences in the proposed and final version of the ETS revision by the European Commission and the European Parliament. This quantitative model is open source and publicly available [here](#), and can be used to understand the impact of the updated legislation on each member state.

In the following section, our partners use the model built by Climact to comparatively evaluate the impact of the updated legislation in three case study countries: Belgium, the Czech Republic and Poland.

BELGIUM (Bond Beter Leefmilieu)

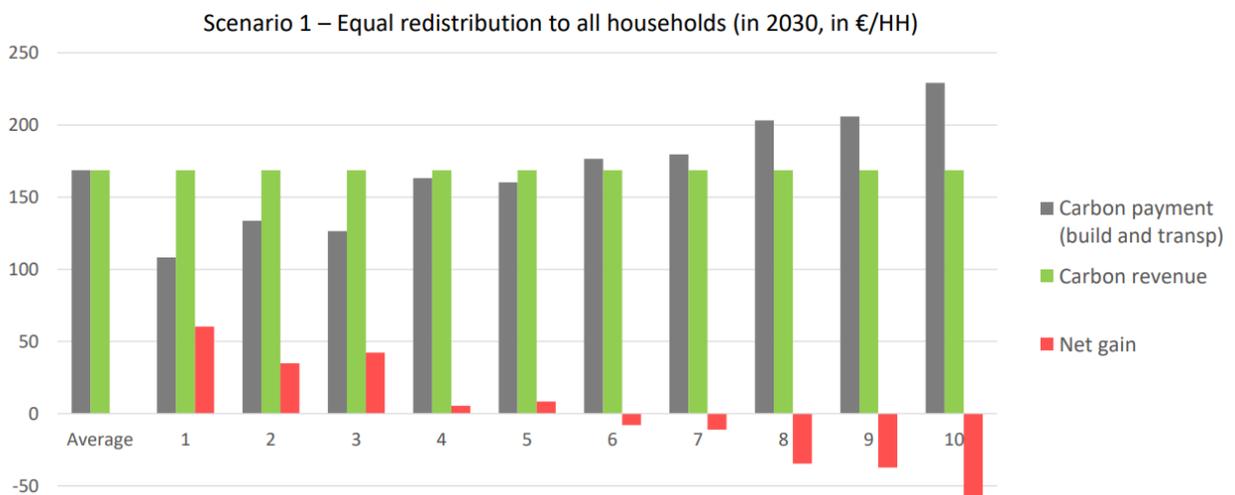
Brief assessment of the EU ETS reform

The introduction of ETS2 was highly controversial in Belgium, particularly in Flanders. The final deal, however, successfully connects environmental and social concerns. The introduction of ETS2 will make a useful contribution in sectors that have proved hard to decarbonise in Belgium. Although concerns about the system's social consequences are justified, the Social Climate Fund and national revenues can be used to alleviate and address structural concerns.

An important responsibility therefore rests with the national and regional governments: it is up to them to employ these instruments in a well-managed, effective and socially just transition.

The introduction of ETS2 means that, for the first time, Belgian households and smaller companies are (indirectly) confronted with a carbon price. A source of major concern is the social impact of ETS2. The federal administration has calculated that, at a price of €44/ton, an average family would have to pay about €125 extra per year (projecting a GHG reduction total of 45%). [Another study, conducted by TML & others](#), projected a similar impact of about €8 in additional monthly heating costs and €4 in additional transport costs.

These studies show that, without corrections, the impact on households will be regressive - although the overall impact is modest compared to the price fluctuations of recent years. However, various studies (specific to Belgium) have shown that it is possible to (over-) compensate for this social impact. Moreover, the influx of a relatively large amount of resources (SCF and auction revenues) offers opportunities for financing social climate policies. See for example the following from the federal administration:



The incomes from ETS2 and the Social Climate Fund provide a solution to Belgium's concerns with this deal. Belgium can claim about €1.7 billion between 2026-2032 from the SCF, circa €250 million per year. Even more important are the 'own' revenues from the auctioned emission rights. For Belgium, these can amount to >€700 million per year (at a price of €45/t), or €5.2 billion for the period 2026-2032.

Recommendations

The task for Belgian policymakers is clear: finalise as soon as possible, the intra-Belgian negotiations on the distribution and governance of the SCF and ETS2 incomes, start drafting the national social climate plan and make sure these plans are closely linked with the ongoing reform of national climate policies in the context of the NECP revision. A clogging up of these resources because of intra-Belgian distribution conflicts is in nobody's best interest.

As provided for in the directive, this should involve adequate consultation with environmental organisations, poverty associations, trade unions and other relevant organisations.

It is also clear what and who should be the primary beneficiaries of this social climate funding: strengthened public services in combination with investment support for vulnerable groups. Investment needs are particularly severe in (regional) public transport and in the building sector, where the transition is financially infeasible for over 40% of households. Part of the budget can then be used to compensate the lowest income deciles.

At the same time, it is best to start working immediately on the introduction of a Belgian CO₂ tax. This would allow Belgium to introduce its own phase-in of carbon pricing over the coming years, and already develop experience with the necessary social correction mechanisms. A 'national' energy tax shift will also make the environmental impact of ETS2 much greater. This should be a priority in the upcoming federal and regional budgetary discussions.

CZECH REPUBLIC (AMO)

Brief assessment of the EU ETS reform

During the EU ETS reform negotiations, Czechia was presiding over the Council and was taking a rather reserved approach to the reform of the system due to its desire to maintain a neutral position, and the need to steer the discussion towards a triilogue. However, during the French presidency, it had been clear that the Czech Republic was not an avid supporter of the sectorial extension of the system to include road transport and buildings. In spite of that, there are many ways Czechia will benefit from the EU ETS reform, and implementation on the national level needs to ensure these benefits are realised.

A separate ETS2 is to be established to cover the road transport and building sectors with mechanisms in place should the price rise above €45 per tonne of CO₂. While the ETS2 will be introduced as of 2027, emissions will have to be monitored and reported as of 2024.

Arguably one of the key features of the reformed EU ETS framework is that all revenue generated by the EU carbon market is for climate spending. The national transposition of the reform in Czechia is to fully follow the requirement as 100% of auctioning revenues will be routed to the State Environmental Fund of the Czech Republic. In terms of auctioning revenues, Czechia is expecting to collect between €28.5 billion and €43 billion until 2030. Most revenues should be collected around 2025 after which the volume of allowances in the system will be decreasing, and subsequently the auctioning revenue too. Czechia has been dividing most of its auctioning revenue between operational support of renewable energy projects and energy efficiency measures. The [New Green Savings](#) programme has been regarded as a great example of carbon revenue use not only in Czechia, but also internationally. The programme supports renovation of family houses and apartments, provides subsidies for solar PV systems, heat pumps, insulation, replacements of windows and doors as well as other measures aimed at achieving energy savings. Between 2014 and 2021, 77,000 beneficiaries received a total of €433 million. The reform of the EU ETS and the 100% allocation of climate measures means that even more funds will be available to support such initiatives. As a result of high energy prices, the programme has become extremely popular, and Czechia has already introduced a reformed version called the [New Green Savings Light](#) which can cover up to 100% of project costs and is thus available even for low-income households.

The Czech Republic has also used the EU ETS directive update as an opportunity to reform its rules for indirect cost compensation. Rules for compensation are to be made more strict and abide by the “rule of 5%”; that is, only those companies whose electricity costs represent at least 5% of the total costs are eligible for the

compensation. This should ensure that only specific businesses vulnerable to increases in the price of electricity can be part of the scheme.

Czechia has been the second largest beneficiary (receiving 15.6% of the total allowances) of the Modernisation fund, second only to Poland. Czechia has also invoked Articles 10(2)b and 10c to increase its share from the fund, taking the total sum received to around 193 million allowances.

The aim of the fund is to support lower-income EU member states in the transition towards climate neutrality, especially via energy system modernisation and energy efficiency measures. The fund is financed from the auctioning of 2% of the total allowances for 2021-2030. Czechia has been using the fund mainly to support energy efficiency actions but also for new renewable energy projects and to modernise the transport sector. Following the EU ETS reform, the Modernisation fund will expand by an additional 2.5% resulting in even more funds available for the country. However, once the fund is based on 2016-2018 GDP results Portugal and Greece will become beneficiaries and the share of the fund allocated to Czechia will drop to 12.6%.

The Social Climate Fund has been one of the priorities of the Czech Republic government's Ministry of the Environment. The former [minister even advocated for more funds to be available in the SCF](#). Czechia has been allocated around 2,4% from the fund's total means, which translates to around €1 billion.

Czechia has not yet presented any concrete plans regarding its NSCP obligations. However, the solution will likely be a mixture of long-term structural investments directed at energy efficiency programmes and renovation of the housing stock, as well as direct support for low-income households.

Recommendations:

The many funding opportunities and auctioning revenues created by reform of the EU ETS framework represents an opportunity for Czechia to make full use of carbon revenues to power the green transition and modernisation of the energy system. At the same time, the most vulnerable households must be shielded from adverse impacts of additional carbon pricing. Programmes directed at energy efficiency measures must be made available for low-income households. As in many previous cases, a lack of public debate between key stakeholders has been at the root of inadequate policymaking. The creation of a forum between public administration and the wider professional public to explore potential solutions and to debate options over auctioning revenue usage would ensure that EU ETS spending is transparent and accountable.

POLAND (Polish Green Network)

Brief assessment of the EU ETS reform

During European trilogues on the reform of the EU's Emissions Trading System (EU ETS) in 2022-2023 Poland was a strong opponent of suggested changes. At the final stage of the legislative process Poland announced that it was opposed to European Council proposals and that it would build a coalition against 'Fit for 55'. Despite the aims being inextricably interlinked, the main argument of the then government against most of the climate-friendly solutions was the need to prioritise geopolitical and economic security over climate outcomes.

However, a new government was elected in October 2023 and is expected to prioritise the green agenda during their term. If the new authorities stay loyal to their campaign promises, Poland has a chance to make significant progress in cutting emissions and towards an energy transition.

It is also important to mention that Poland is one of the biggest beneficiaries of the ETS in the EU. Between 2013 and 2021 it earned over €13,5 billion, which should have been spent on the reduction of emissions. [As highlighted by WWF](#), Poland is the member state with the most ETS revenue not spent on climate action to date at €6.5 billion. The new government declared it will allocate ETS revenues to modernise power grids in Poland as insufficient capacity of current grids are one of the key barriers of the country's energy transition.

To date, Poland has agreed with the European Investment Bank, which oversees the Modernisation Fund, to launch 15 programmes at a cost of €1.2 billion. Many of these plans are much needed such as power grid stabilisation, smart energy meters and support for energy communities. On the other hand, the EIB has faced criticism for allowing the financing of four fossil fuel projects. All are to create cogeneration units (combined heat and power generation) that may be powered by fossil gas. Another large-scale programme supports waste incineration, which contradicts EU climate policy.

Civil society criticised the [national operator of the Modernisation Fund in Poland](#), for a lack of transparency. However, following numerous interventions at the national and European level, processes for increased transparency are being gradually introduced.

Regarding the ETS2, Poland will be the largest beneficiary of the new Social Climate Fund, expected to receive €12.7 billion, which equals to over 17 percent of the fund's entire budget. To receive the SCF money each member state must submit a National Social Climate Plan. Before it is submitted, there must be a participatory process including consultations with civil society.

Recommendations

At the moment it is very important that the public opinion is made aware of the benefits and consequences of ETS reform. Media campaigns that explain how it is going to work and how we can prepare for it require appropriate narrative and detail. There is a need to pressure the national government into using the available funds for Poland's energy transition. It is also important for CSO's to work closely with the authorities in order to ensure proper consideration of social justice concerns within the National Social Climate Plan.

ETS TIMELINE



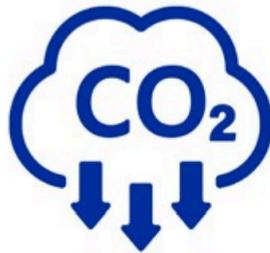
Messaging

While there are many issues to consider in the efforts to improve the equity and effectiveness of the EU ETS the communication efforts at national level can be broken down into three clear demands. These are the most important considerations to improve ETS implementation and the priorities for the 2026 revision.

EU Level



1 MAKE POLLUTERS PAY



2 SPEED UP EMISSION REDUCTIONS



3 DON'T ALLOW ANOTHER PRICE CRASH

Member State level



Complementary policies needed to ensure access and affordability of emissions reductions



Efficient spending of ETS revenue for effective and just climate action



No more fossil fuel investment or subsidies

