
# Teneo Insights: Europe’s “Fit for 55” package – what to expect

The European Commission is expected to present a package of legislative proposals on 14 July to get the EU on track for achieving its 2030 target of reducing net greenhouse gas emissions by at least 55 percent below 1990 levels. With this so called “Fit for 55” package, the Commission is delivering on the climate pillar of the EU Green Deal, translating the ambition outlined in the European Climate Law into concrete legislation. It puts meat around the bone of the EU’s intentions, reaffirming the credibility of its green deal agenda and climate commitments both internally and externally.

The package will be the subject of intense and complicated negotiations in the EU’s lawmaking institutions – the Council of the EU representing national governments, and the European Parliament – well into 2022, which will inevitably lead to modifications. The final content might also be influenced by the upcoming international climate change negotiations, COP 26, in Glasgow in November. While the details of the “Fit for 55” package will only be known once the proposals are published, the direction of travel outlined in this briefing is now set.

## What’s in it?

The “Fit for 55” package is about tightening the nuts and bolts of the EU’s climate and energy regulatory framework. The current framework is calibrated against a 2030 greenhouse gas emission reduction target of at least 40 percent. In December 2020, EU Member States agreed to increase that target to at least 55 percent. The recently adopted Climate Law translates this objective into law, making the bloc legally bound to achieve 55 percent emissions cuts by 2030 and ‘climate neutrality’ by 2050. This is no small feat: it requires a doubling of the current rate of annual emissions cuts, across the economy, until the middle of the century.

The package is likely to be the largest legislative package the Commission has ever rolled out, making changes to a batch of laws that make up the core of the EU’s climate and energy legislation in one go. It will include revisions of eight existing laws including on the emissions trading system (ETS), renewable energy, energy efficiency, emission standards for cars, and energy taxation. Four new initiatives will include a carbon border adjustment mechanism (CBAM) and a social facility to protect vulnerable consumers. It leaves no sector untouched and will affect governments, businesses and consumers alike.

Towards the end of the year, an additional set of complementary proposals covering energy performance of buildings, decarbonized gases, and methane emissions in the energy sector are expected. These will address *inter alia* the role of gas in the energy transition, which is one of the EU’s big remaining strategic choices.



## Continuity or change?

The package builds on the existing architecture of EU climate policy, which splits the overall greenhouse gas emissions reduction target in two: an emissions trading system centrally regulated at EU level for big emitters including the power sector, heavy industry and aviation on one hand, and national targets for other sectors such as transport, buildings, waste and agriculture on the other hand. This is complemented by EU targets and instruments to promote renewable energy and increase energy efficiency, which play a central role in reducing greenhouse gas emissions, and a number of sector specific policies such as on cars and buildings. These targets and instruments need to be updated to align with, and contribute to, the overall level of ambition. Their success will depend on the capacity of the EU and Member States to implement policies and redistribute resources accordingly.

A significant change to the current set of rules includes the expansion of emissions trading to the maritime sector as well as buildings and transport. Another major update is the introduction of a carbon border levy for a number of carbon intensive goods such as electricity, steel, aluminum, cement and fertilizers, which is to replace the current system to prevent the risk of 'carbon leakage'. The update also foresees a new role for the land use sector, including agriculture, which is expected to remove more carbon from the air and balance remaining emissions in other sectors in order to reach the goal of net-zero emissions.

## Difficult road ahead

A number of issues are likely to prove particularly difficult in the upcoming negotiations. This includes changes to the ETS where the EU is considering cutting or eliminating free CO2 allowances for sectors at risk from carbon leakage. This is a very sensitive issue for the concerned sectors, particularly as new initiatives such as the carbon border adjustment mechanism may call into question the existence of free allowances altogether.

The carbon border adjustment mechanism itself is controversial both internally within the EU, with Germany concerned that the proposal may impact its export-oriented industry, and externally with the EU's main trading partners who see it as a protectionist trade barrier. Getting CBAM approved will require cooperation with the bloc's trading partners, and mechanisms that encourage the introduction of carbon-reduction measures globally rather than just punishing countries that host CO2-emitting industries. The EU's plans in this regards are complicated by the fact that only a few countries around the world have so far introduced or plan to introduce carbon pricing schemes similar to the one developed by the EU.

Another delicate issue is the expansion of emissions trading to new sectors. Proponents argue that it is an effective way to get emissions under control while raising revenues to support the transition. But the planned expansion to the maritime sector beyond domestic routes will also irritate trading partners. And the expansion to buildings and transport will have a direct impact on households in the form of higher housing and fuel costs, disproportionately affecting the most vulnerable. The new social facility to be presented as part of the package is intended to mitigate the impact of these measures, but there are doubts over how


effective it can be. And the effectiveness of carbon pricing to foster emission reductions and fuel switching in those sectors is more limited due to price inelasticity and technological lock-ins.

The proposals are also to address concerns related to the sustainability of bioenergy, which makes up around half of renewable energy in Europe. The Commission is considering strengthening the sustainability criteria for bioenergy to incentivise only the more sustainable forms of bioenergy, and wants to minimise the use of whole trees for energy purposes, a move welcome by environmental groups but unpopular with the bioenergy industry and countries with a strong forestry sector.

The fate of the internal combustion engine will also prove to be a delicate issue. Transport emissions keep rising and zero-emission vehicles are seen as a way to reverse that trend. The Commission is considering setting a zero emission standard around 2035 which would mean a *de facto* end date for the internal combustion engine. With electric vehicles the only option in such a scenario, this means a rapid transformation of the auto industry, one of Europe's core industries, and depriving promoters of bio- and synthetic fuel technologies of one of their main potential markets.

Any measures relating to energy taxation will also prove difficult. At a legislative level, such measures require unanimity among Member States, rather than a majority vote, which is the case for most other laws. An the introduction of a tax on fuels used by ships and planes will also cause trade friction and rekindle concerns about European competitiveness in a global marketplace.

## Prospects for a deal

For Member States and the European Parliament to reach an agreement on the "Fit for 55" package will require a delicate balancing act. While it is unlikely that it can be dealt with as a single package, there are clear links between elements of the package that will need to be negotiated in parallel. There will inevitably be some horse-trading across the different pieces of legislation in order to get an overall deal done.

This deal will notably have to be fair towards low-income and coal-dependent countries, ensure the protection of vulnerable sectors and groups and safeguard social protections, and support progress at global level. Success will also depend on whether EU lawmakers can convince national governments in the bloc, markets and citizens that this is a strategy for growth rather than a weight around the EU economy's neck.

The importance of the international dimension should not be underestimated: while the EU wants to be a climate leader and come to the table with one of the world's most ambitious packages, it may need to show flexibility in some areas, such as the carbon border adjustment mechanism, to achieve an ambitious global deal at the COP26 climate summit and beyond.