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INTERNATIONAL SUSTAINABLE FINANCE CENTRE

Fit for 55 package press release:
Opportunities and risks for CEE

SUMMARY

- Today, the European Commission released the Fit for 55 Package, what it calls “a comprehensive and interconnected set of proposals” for the EU to achieve a 55% net reduction in CO2 emissions by 2030.
- The Package reforms key climate policies such as the Emissions Trading Scheme (ETS) or Effort Sharing Regulation (ESR). It also introduces new measures such as the Carbon Border Adjustment Mechanism (CBAM)
- The Package fails to consider the particular needs of the CEE region and attempts to implement “one-size-fits-all” measures that might leave the CEE behind in the economic and climate transition.
- Achieving Fit for 55 will be more challenging for CEE countries due to the carbon intensity of their energy, transport and industrial sectors.
- To avoid a “Green Iron Curtain”, the EU must adopt social and solidarity measures and ensure a tailored approach that takes into account the CEE circumstances and challenges to promote both a green and a socially inclusive transition.
- Increased costs in energy prices, housing and transport costs could negatively impact industry and low-income consumers and result in popular and political backlash against the “green” agenda.
- The Package provides additional revenues for climate, energy and social measures through expansion of the ETS and the Social Climate Fund which need to be communicated and implemented in a timely and effective manner.

OVERVIEW

Today, the European Commission released the Fit for 55 Package, consisting of a combination of new, revised and amended Regulations and Directives designed to fundamentally overhaul the EU’s climate policy architecture and achieve its goal of a net reduction in greenhouse gas emissions of at least 55% by 2030. The package is a combination of revised and amended Regulations and Directives and new policies. **While the package is comprehensive and ambitious, it fails to consider the particular needs of the CEE region and attempts to implement “one-size-fits-all” measures that could leave the CEE behind in the economic and climate transition.**

QUOTES

Linda Zeilina, Founder and CEO, ISFC

> “Failure by the CEE governments to take initiative and use the Fit for 55 package and especially the ETS revenues strategically risks creating a new ‘green’ iron curtain, preventing convergence and exacerbating the two speed Europe”

David Murphy, Head of Strategy and Development, ISFC

> “An ambitious Fit for 55 is welcome and necessary. Europe needs to play a leadership role in the global fight against climate change. However, it can’t come at the expense of the most vulnerable in our own societies. CEE faces greater challenges in decarbonisation than larger and wealthier Member States. This consideration needs to be built into the infrastructure of the package.”

David Němeček, Research Fellow, ISFC

> “A truly successful scaling up of the renewables sector in the fossil fuel-dependent CEE region will require huge investments, much higher than what public funding can cover. Therefore, CEE countries need to be supported in attracting private investors.”

Claire Godet, Visiting Fellow, ISFC

> “The Fit for 55 Package is not as ambitious as we hoped. This gives the CEE a great opportunity to implement national and regional measures to become a leader in the energetic and economic transition.”

Adela Syslová, Head of Engagement, ISFC

> “The introduction of a Carbon Border Adjustment Mechanism is a bold move to motivate decarbonisation on a global scale. However, it will be key to communicate well both with trade partners, who can see the measure as protectionist, and European industries, who will have to adapt to the phase-out of free allocations of carbon allowances.”

This is a preliminary analysis of those elements that most fundamentally impact the CEE region and we will provide a more comprehensive review of the package at a later stage.

1. Proposed Revision of the Emissions Trading Scheme (ETS) and Effort Share Regulation (ESR)

> The EU ETS and ESR are cornerstones of the EU's climate policy. ETS creates a cap-and-trade system on CO2 emitted by businesses and industry and covers 40% of total EU emissions. ESR creates binding targets for emission reductions in all other areas not covered by ETS with reductions based on the GDP of Member States. The current proposal will transfer, from 2026, transport and buildings into a hybrid system where they are included in a second ETS and in ESR. This allows Member States to take complementary measures to help decarbonise these sectors. The Commission will also create a Social Climate Fund to address the social challenges that vulnerable groups in society may face as a result of the new ETS. The proposal also reduces the total cap and the number of allowances in the ETS.

ISSUES IN CEE

The ETS and the ESR are complemented by funds and mechanisms that will help solve some social challenges occuring from the transition. However, the current measures should be improved to meet the 2030 targets. The proposal on the ETS reduces the number of free carbon allowances but does not cancel them. Free allowances can be exploited as subsidies for high emitting industries. Cancelling free allowances is necessary to achieve the 55% target but can negatively impact fossil fuel dependent industries in CEE making this a controversial issue. Additionally, the shifting of transport and buildings from ESR to ETS potentially shifts liabilities and costs of decarbonisation from industries and corporations to consumers. Moreover, scrapping the binding targets for the transport and building sectors will considerably slow emission reductions, and since these sectors will be granted free allowances until 2026, there will probably be an increase or no emission reductions. The EU is proposing compromises and loopholes in the ETS reform to make it politically acceptable to CEE and other policy makers. CEE leaders and policy makers are willing to use these compromises to their own detriment in the long-term.

2. Proposal for a Carbon Border adjustment Mechanism CBAM

> The Carbon Border Adjustment Mechanism (CBAM) is a tariff on imported goods based on their carbon content and set according to current carbon prices as established by ETS. The CBAM is expected to cover only imported goods of certain sectors at risk of carbon leakage: cement, certain fertilizers, iron and steel, aluminum as well as electricity. Importers of these products would need to purchase CBAM certificates per tonne of CO2 embedded in the goods putting them on par with locally produced products subject to ETS.

ISSUES IN CEE

Initially, most CEE countries supported CBAM as a protectionist measure to safeguard the competitiveness of their industries. However, there are still unresolved issues that will need to be clarified. The main concern is related to free the allocation of carbon allowances under EU ETS for industries covered by CBAM. Free allowances will be phased-out gradually after 2026, when CBAM will come into effect. There are concerns that without them increased carbon prices will negatively impact carbon intensive industries in CEE that will take longer and be more expensive to decarbonise given their heavy dependence on fossil fuels. However, this can potentially be offset through additional revenue from CBAM reinvested in NextGenerationEU.

3. Proposed Revision of the Renewable Energy Directive (REDII)

> The amendment sets a higher binding renewable energy target for the EU for 2030 of at least 40% in final energy consumption with a clause for a possible upwards revision by 2023 and it attempts to anchor the EU taxonomy in the energy sector by defining green sources of energy.

ISSUES IN CEE

CEE energy systems are highly dependent on non-renewable sources such as coal and nuclear. Currently, several countries (BG, CZ, PL) do not have a concrete coal phase out date and several others (BG, CZ and HU) are planning to increase the share of nuclear energy in their energy mixes. Furthermore, many CEE policy makers are convinced that there is no alternative to a temporary transition to gas until renewable sources are scaled up and especially to maintain district heating systems. However, investments in gas will potentially create stranded assets. Meeting the targets of REDII will demand both policy changes and massive investments. The heavy dependence of some CEE countries on fossil fuels for energy and heating has no equivalent in Western Europe. Therefore, the public funding from the Modernisation Fund, the Recovery and Resilience Facility and the Just Transition Fund will need to be complemented by private investments in a region where “green” financing tools are underutilized. The amendment also aims to classify which energy sources are green. In this sense the classification of gas and nuclear are highly controversial.

4. Proposed Revision of the Regulation on Land Use, Land Use Change and Forestry LULUCF

> The main aims are to increase the ambition of carbon sinks, to strengthen the criteria under which these are managed and to provide a stronger EU Forestry Strategy. The revised Regulation enshrines the commitment for the first time in EU law for the period 2021-2030. Moreover, the scope is to be extended from only forests today to all land uses (the upcoming New Soil Strategy, EU Nature Restoration Law and Carbon Farming Initiative).

ISSUES IN CEE

The CEE region has a wealth of extensive forests, yet some countries are facing major challenges to maintain favourable conservation status (FCS) in and beyond their Natura 2000 sites. Romania, which has the largest area of virgin forests in the whole of the EU is facing an illegal logging crisis severe enough to prompt the European Commission to open an infringement procedure. Czechia is dealing with an unprecedented bark-beetle pandemic that has destroyed much of its coniferous forests. In both cases the public administration has been unable to confront the issues effectively. Furthermore, sustainable land use in the region was severely impaired by the history of collectivist agriculture. This is especially problematic in Poland where agricultural land constitutes 50% of the country's total area.

5. Proposed Revision of the Regulation setting CO_2 emission performance standards for new passenger cars and for new light commercial vehicles

> The proposed revision aims to reduce average emissions of new cars to come down by 55% from 2030 and 100% from 2035 compared to 2021 levels. As a result, all new cars registered as of 2035 will be zero-emission.

ISSUES IN CEE

CEE countries of CZ, HU, PL, RO and SK produced over four million vehicles in 2019 or roughly 25% of total EU production. CEE economies, especially Czech Republic and Slovakia, are heavily dependent on the automotive industry which accounts for more than 9% and 13% of GDP respectively. Given the clear economic dependency on the automotive industry, unsupported decarbonization can have grave impacts on competitiveness, livelihoods and public opinion. This is also true for components businesses as electric vehicles contain, on average, around 30-35% fewer moving parts than a traditional vehicle. This element of the package represents what could be considered by policy makers in the region as a threat to CEE economic stability.

CONTACT FOR COMMENTS

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