Questions and Answers – Strengthening and expanding EU Emissions Trading with a dedicated Social Climate Fund to help citizens in the transition

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How has the EU Emissions Trading System been strengthened?

The review of the EU Emissions Trading System (EU ETS) Directive **strengthens the existing EU ETS and extends carbon pricing to new sectors.** The environmental ambition of the EU ETS was substantially strengthened by the agreement to **lower the overall emissions cap**. Emissions from the EU ETS sectors will **have to decrease by 62% by 2030, compared to 2005**, representing a substantial increase from the previous objective of 43% emissions reductions. The **speed of annual emission reductions will increase** from 2.2% per year under the current system to 4.3% from 2024 to 2027 and 4.4% from 2028. The Market Stability Reserve was also strengthened: this rule-based mechanism is designed to stabilise the carbon market by removing surplus allowances, and to improve the system's resilience to major shocks by adjusting the supply of allowances to be auctioned.

The manufacturing industry will continue to receive a limited share of **free allowances** to address the risk of '**carbon leakage'**. Carbon leakage refers to the situation that may occur if, for reasons of costs related to climate policies, businesses may transfer production to other countries with laxer emission constraints: that means fewer emissions in the EU but more emissions globally. The rules for free allocation reward the most efficient installations. The system of free allocation has worked well in preventing carbon leakage, but to ensure that these industries pay an increasing carbon cost and are incentivised to reduce emissions, the revised ETS will gradually phase out free allocation allowances to certain enterprises. In parallel the **new Carbon Border Adjustment Mechanism (CBAM)** will be phased in between 2026 and 2034 for some sectors, to maintain a level playing field while effectively pricing carbon.

The revised EU ETS will include **maritime transport emissions** from 1 January 2024, covering around two thirds of emissions in the sector (90 million tonnes CO2), and complementing the new Regulations on FuelEU Maritime and Alternative Fuels Infrastructure to help drive down emissions faster in the sector through the uptake of renewable and low-carbon fuels and infrastructure. For **aviation**, the revised EU ETS rules applying to the sector will accelerate the implementation of the polluter pays principle, by phasing out free allowances by 2026 which currently cover 85% of aviation emissions.

To support efforts to reduce emissions from **buildings and road transport** a new **separate emissions trading system** (known as ETS2) will start operating in 2027. Revenues generated by this separate ETS will fund the new **Social Climate Fund** **(SCF)** that will ensure that the transition is fair for all.

How does the EU reinvest the money generated by emissions trading?

The majority of EU ETS allowances are auctioned almost daily at the European Energy Exchange (EEX), a commodity exchange platform. Most of the revenues from these auctions flow back to the Member States. Since 2013 auctions have raised **more than €150 billion**. Member States spend around 75% of these revenues on climate-related purposes. Now, as part of the revision, it was agreed that Member States must spend **all of their revenues on climate-related projects**.

The Social Climate Fund will provide €65 billion to the Member States to finance measures and investments identified in new Social Climate Plans. Together with the Member States' contributions (at least 25% of the costs of their plans), the Social Climate Fund will mobilise €86.7 billion. The Fund will support the most vulnerable groups through structural measures and investments in energy efficiency, the renovation of buildings (e.g. insulation), clean heating and cooling (e.g. heat pumps), and integration of renewable energy (e.g. solar panels) as well as in zero- and low-emission mobility and transport, including public transport.

Part of the ETS allowances are auctioned specifically to finance the Innovation Fund and the Modernisation Funds. The size of both funds has been increased with this reform.

The **Innovation Fund** is one of the world's largest funding programmes for the demonstration of low- and zero-carbon innovative solutions and technologies in the areas of energy, energy intensive industry, mobility and buildings, funded entirely from the EU ETS and estimated at €40 billion until 2030 (depending on the carbon price). The Fund has so far provided grants for projects through calls for proposals and project development assistance. Following the revision of the ETS Directive, the Fund has a larger scope (including new sectors such as maritime) and features additional instruments (competitive bidding) to cater to market needs and notably also to support more mature projects. The Innovation Fund will provide the budget for a European pilot auction for the production of renewable hydrogen to be launched in November 2023 as the domestic leg of the European Hydrogen Bank.

The **Modernisation Fund** is a funding programme that currently supports ten lower-income Member States (Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia) in meeting 2030 climate and energy targets by helping them to modernise their energy systems and improving energy efficiency. The revision of the ETS Directive brings important changes to the Modernisation Fund in terms of size and governance. In addition to the initial 640 million allowances, a top-up of 110 million allowances is shared between 13 beneficiary Member States – the 10 original beneficiaries plus Greece, Portugal and Slovenia. The total disbursements from the Modernisation Fund since January 2021 amount to around €7.5 billion.

How will the new separate Emissions Trading System apply to buildings and road transport and how would you support these sectors and households?

To support efforts to reduce emissions from buildings and road transport and fuel combustion in industry not covered by the existing ETS, a **new separate emissions trading system will start in 2027**. The start may be postponed to 2028 in case of exceptionally high oil or gas prices.

The new system will ensure cost-effective emission reductions from those two sectors, which have been insufficient so far, and will be crucial to put the EU on a firm path towards its goal of reaching climate neutrality by 2050.

The new system for buildings and transport is an upstream system that will regulate distributors of fuels for buildings and road transport rather than households and drivers. **Several safeguards are put in place to allow for a smooth start of the** system and to ensure that there is no abrupt price shock for the consumers or households.

To ensure that the green transition is fair and leaves no one behind, the **Social Climate Fund** is created to use the revenues of this system to address the social impacts of emissions trading on vulnerable households and micro-enterprises. It will operate from 2026 until 2032. Thus, it starts operating at least one year before the launch of the new ETS to prepare for and minimise the impacts. Moreover, the Member States are required to spend all their auction revenues from the ETS for buildings and transport on climate action giving priority to investment supporting the transition in the covered sectors and activities that can contribute to addressing social dimension.

How will the revised EU ETS reduce emissions from aviation?

The EU ETS system for aviation currently covers flights within the EEA and departing flights to Switzerland and the UK. From 1 January 2024, the revised EU ETS also covers **non-domestic flights to and from outermost regions that were previously exempted**, increasing the amount of emissions covered by 7%.

The total number of available allowances for aviation will be stabilised at current levels, and the linear reduction factor will apply. **Free allocation will be reduced by 25% in 2024, 50% in 2025, and with a complete phase out and full auctioning from 2026 onwards.** That way, a robust price signal will be in place providing more economic incentives to cut emissions and the aviation industry will take its fair share of climate action and pay for its carbon footprint.

To **incentivise the use of sustainable aviation fuels**, there are 20 million allowances reserved for covering a part or the whole price difference between the eligible fuels and the fossil kerosene, in other words a share of EU ETS revenues estimated at around €1.6 billion (depending on the carbon price) will be available specifically to invest in sustainable transport fuels. The EU ETS also incentivises the use of these fuels by assigning a zero-emission factor to them, thus emissions from these fuels are not linked with an obligation to surrender allowances, unlike for fossil kerosene.

The Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) of the International Civil Aviation Organization (ICAO) is implemented for flights that are not covered by the EU ETS, namely for flights outside the EEA (except flights to and from Switzerland and the UK, which are covered by the EU ETS and the respective ETSs). In 2026, the Commission will carry out an assessment of CORSIA, to see if it is sufficiently delivering on the goals of the Paris Agreement. If CORSIA will be strengthened and the level of participation will be sufficiently high, the scope of the EU ETS will be maintained. Otherwise, the Commission will be obliged to propose to extend the EU ETS to all departing flights, with the possibility to deduct CORSIA-related compliance costs.

Moreover, the revised aviation ETS will also create a new system for airlines to monitor, report and verify non-CO2 emissions and climate effects of aviation, which make up two thirds of aviation's total climate impact. Transparency will also be increased with more data on international aviation emissions published in a user-friendly manner, while protecting commercially sensitive data.

How will the revised EU ETS reduce emissions on maritime transport?

In January 2024, the EU ETS will be extended to the maritime transport sector to **cover CO2 emissions from all large ships (of 5 000 gross tonnage and above) entering EU ports, regardless of the flag they fly**. From 2026, it will also cover methane and nitrous oxide emissions.

The system covers:

- 50% of emissions from voyages starting or ending outside of the EU (allowing the third country to decide on appropriate action for the remaining share of emissions);
- 100% of emissions that occur between two EU ports and when ships are within EU ports.

The new rules will generate revenues for national governments to reinvest in the green transition of the shipping industry, and the price signal will incentivise energy efficiency, low-carbon solutions, and reductions of the price difference between alternative fuels and traditional maritime fuels. The system builds on the provisions in place for other EU ETS sectors, as well as the recently revised EU Monitoring, Reporting and Verification Regulation for maritime transport ('MRV Maritime Regulation'). To ensure a smooth transition, shipping companies only have to surrender allowances for a portion of their emissions during an **initial phase-in period**:

- 2025: for 40% of their emissions reported in 2024;
- 2026: for 70% of their emissions reported in 2025;
- 2027 onwards: for 100% of their reported emissions.

A **reporting and review clause** is included to monitor the implementation of the rules applicable to the maritime sector, in particular to detect and address evasive behaviour at an early stage, and to take into account relevant developments in the International Maritime Organisation (IMO).

Frequently asked questions are available to guide shipping professionals in understanding the application of the EU Emissions Trading System to maritime transport.

For More Information

Press release

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Press contacts:

Tim McPHIE (+ 32 2 295 86 02)
Ana CRESPO PARRONDO (+32 2 298 13 25)

General public inquiries: Europe Direct by phone 00 800 67 89 10 11 or by email