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Editorial

Good Intentions and a Call for Higher Speed on the Bumpy Road to Carbon Neutrality

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Last year, around this time, I went into some policy measures proposed by the United Nations Framework Convention on Climate Change (UNFCCC) and the European Commission aimed at limiting the fast increase of the global temperature.[1] In this editorial, I will try to give a bird's eye view of the continuing efforts to achieve a substantial reduction of emissions in 2030 and carbon neutral world in 2050.

1 The global picture: A call for urgency

On 13 November 2021, the Conference of the Parties (COP26)[2] adopted an outcome document, together with a wide-ranging set of decisions, resolutions, and statements. In his closing speech at the conference, António Guterres, Secretary-General of the UN, said the outcome *'reflects the interests, the contradictions and the state of political will in the world today'*. But he added: *'It's an important step but not enough. We must accelerate climate action to keep alive the goal of limiting global temperature rise to 1.5 degrees'*.[3] Perhaps the most important outcome of the Glasgow COP26, six years after the 'Paris Agreement' adopted at COP21 in Paris,[4] is the formal decision to achieve that limit of 1.5 degrees rise in global temperature, compared to the level in 1990, by the mid of this century.

In doing so, COP26 has taken a tremendous challenge. It requires a faster reduction of the anthropogenic emissions of greenhouse gases, notably carbondioxide (CO2) to 'net-zero'.[5] According to the Climate Action Tracker,[6] if we succeed in achieving the present CO2 reduction targets for 2030 (45% reduction), global temperature will rise around 2.4°C above the 1990 level (best case scenario 1.9°C, worst case scenario 3°C). If further pledges and targets for the following decennia would be achieved, in the most optimistic scenario the rise in temperature would be between 1.5 and 2.4°C. In fact, the target of global net-zero CO2 emissions around 2050 entails a global 'carbon budget' that should decrease until around 2050 and stay at that level after 2050. Moreover, the global carbon budget should be spread among the countries involved and translated into Nationally Determined Contributions (NDCs). According to the principle of 'Common but Differentiated Responsibilities and Respective Capabilities', as applied by the UNFCCC, developed countries should continue taking the lead by undertaking economy-wide absolute emission reduction targets. Differentiation between developed, emerging and least developed countries has always been an issue; developing countries blamed the developed countries for their history of high emissions. The tension between them even led to the failure of the Copenhagen Accord in 2009 (COP15). This explains why COP26 emphasized the need to build resilience of vulnerable communities against the loss and damage of climate change and create robust financial support beyond USD 100 billion per year for developing countries already suffering loss and damage from global warming.

2 The EU picture: 'Fit for 55'

In his speech on 24 November at the European Parliament Plenary on COP26, Frans Timmermans (Executive Vice-President of the European Commission) proudly said the European 'Fit for 55' package (to be adopted before COP27, next year) means that the EU is putting pressure on others *'to step up their game'*, adding *'we* [HK: read the EU] *are the only ones who have a real plan to get us to our (… .) legally binding emission reductions by 2030 and 2050*'.[7]

The 'Fit for 55' package finds its base in the Green Deal that was presented by the European Commission in

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1 EC Tax Review, vol. 29(5), at 208 a.f.

2 The 26th Conference of the Parties, the decision-making body of the UNFCCC, was held in Glasgow, UK, from 31 Oct. through 13 Nov. 2026. COP27 will be held in Sharm El-Sheik, Egypt, from 7 through 18 Nov. 2022.

3 *See* https://news.un.org/en/story/2021/11/1105792 (accessed 11 Dec. 2021).

4 In the Paris Agreement, the target for 2050 was a limit of well below 2°C increase, preferably 1.5°C, in global temperature above the 1990 level.

5 Net-zero CO2 emissions means no more anthropogenic CO2 emission than can be absorbed (removed out of the atmosphere) by forests and grasslands.

6 *See* https://climateactiontracker.org (accessed 11 Dec. 2021).

7 This speech was given on 24 Nov. *See* https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_21_6267 (accessed 11 Dec. 2021).

December 2019. One year later, the European Council confirmed its commitment to the Green Deal,[8] endorsing a binding EU target for an increased reduction in net domestic greenhouse gas emissions (mainly CO2) from initially 40% to at least 55% by 2030 compared to 1990 levels. On 24 June 2021, the European Parliament ratified the European Climate Law. The Council called upon the European Parliament to reflect this new target in the European Climate Law, and in July 2021, the Commission presented the 'Fit for 55' package including proposals and initiatives to revise EU legislation to become aligned to the 2030 and 2050 climate targets of the EU.[9]

The package includes inter alia proposals for a reform of the EU Emissions Trading System (EU ETS[10]), the introduction of a Carbon Border Adjustment Mechanism (CBAM), and a substantial revision of the Energy Tax Directive (ETD).

As regards the ETS, the proposals can be summarized as follow. The scope of the ETS will be extended to the maritime sector, and the linear CO2 reduction factor will be increased from 2.2% to 4.2% per year, bringing about a steeper trajectory for reducing the number of emission allowances. Moreover, there will be a one-off reduction of the cap on the total number of allowances.

The current provisions on free allocations[11] (free emission allowances have been introduced to avoid 'carbon leakage', i.e., shifting CO2 emissions to elsewhere in the world) will be continued. Free emission allowances for aviation will be phased out with full auctioning in 2027. For sectors falling under the proposed CBAM (see hereinafter) free allowances in the ETS will be phased out, mirroring the phase-in of the charge levied under the CBAM.

The proposed introduction of an EU-wide CBAM, covering five high energy-intensive sectors – iron and steel, cement, fertilizers, aluminium and electricity – will have the legal form of a Regulation of the European Parliament and the Council and should come in force in 2023.[12] Is should create a common and uniform framework to ensure an equivalence between the carbon pricing policy applied in the EU's internal market and the carbon pricing policy applied in non-EU countries from which goods are imported into the EU. The adjustment mechanism should prevent carbon leakage caused by EU producers who move their activities to non-EU countries that have less ambitious policies for climate change than the EU and subsequently export their products (with a lower carbon price than in the EU) to traders in the EU. The CBAM will apply a charge on such imports of goods at the price of carbon determined by the EU ETS system through the system of auctions. Importers will either be charged on the basis of a default value or based on the actual emissions embedded in the imports.

At this moment the ETD de facto favours fossil fuel use as a result of highly divergent national rates applied in combination with a wide range of tax exemptions and reductions.[13] The proposed revision of the ETD will bring a far-reaching change in the taxation of energy products an electricity, including a change of both the tax base and the tax rate structure.[14] In the explanatory memorandum of the proposal, the Commission states that the present ETD is no longer in line with EU climate and energy objectives, as this directive does not adequately promote greenhouse gas emissions reductions, energy efficiency and the take-up of electricity and alternative fuels (renewable hydrogen, synthetic fuels, advanced biofuels, etc.). Therefor the tax base will be changed from volume (litres of fuel of kilogrammes of gas) to energy content, eliminating incentives for fossil fuel use and introducing a ranking of rates according to the environmental performance, thus internalizing the cost of carbon in the price of the energy products and electricity that the polluter should pay. In view of the coherence within the 'Fit for 55' package, the proposal for recasting of the ETD and the proposal revising the EU ETS complement each other. As also mentioned in the explanatory memorandum, the legal basis of the proposed revision of the ETD is Article 113 of the Treaty of the Functioning of the European Union (TFEU), ruling that adoption of provisions on tax harmonization necessary for the functioning of the internal market, requires unanimity of the Council. In the next sentence, the Commission states: '*Additionally, appropriate provisions of fiscal nature intended*, inter alia, *to preserve and protect the environment can be adopted according to Article 192(2), first subparagraph of the TFEU*'. With this sentence, in context with Article 192 (1) and Article 191 TFEU, the Commission now seems to confirm that the proposed revision of the ETD is a provision primarily of a fiscal nature and thus to be adopted by the Parliament and the Council by unanimous voting.[15]

8 *See* https://www.consilium.europa.eu/en/meetings/european-council/2020/12/10-11/ (accessed 11 Dec. 2021).

9 The EU target for 2050 is net-zero emissions of CO2.

10 The EU ETS, a 'cap and trade' system resulting in carbon prices for emission allowances, was introduced in 2005 for energy-intensive sectors. *See* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003L0087&from=EN (accessed 11 Dec. 2021).

11 Free allowances will be received up to a benchmark set at the average emission level of the 10% most efficient emitting installations in a specific sector. Free allowances are an exception to the rule that emission allowances, if not acquired on the trading market, are acquired by auction, thus reflecting the 'carbon price'.

12 *See* https://ec.europa.eu/info/sites/default/files/carbon_border_adjustment_mechanism_0.pdf (accessed 11 Dec. 2021).

13 For sectors that may currently benefit from total exemptions – such as aviation, or heating fuels for non-vulnerable households – the proposal of the revised ETD includes transition periods to mitigate the economic and social costs of introducing taxation.

14 *See* https://ec.europa.eu/info/sites/default/files/revision_of_the_energy_tax_directive_0.pdf (accessed 11 Dec. 2021).

15 In 2019, the European Commission tried several times to change the voting rules for adoption of the proposed revision of the ETD from 'unanimously' into 'by qualified majority'. *See also* my editorial in EC Tax Review, vol. 29(5), at 210 and 211.

3 Council of the EU: Preparing the legislative process

Up to now, there have been informal and preliminary discussions on the 'Fit for 55' package in four Council formations: the Environment, Energy, Transport, and Economic and Financial Affairs Counsel. The outcome can be summarized as follows:

– In an informal meeting on 20 July 2021, the Environment Council welcomed the package, stressing that fairness, solidarity, ambition, and efficiency among the EU Member States should be the guiding principle.[16] They see the ETS as *'the cornerstone of EU's climate policy'*.
– On 22 September 2021, the Transport and Energy Councils discussed the package, focusing on the revision of the directive on the promotion of the use of energy from renewable sources and the energy efficiency directive.[17] Energy production and use account for 75% of emissions in the EU, of which one third for transport. As mentioned in the press release after the Councils' meeting, both sectors (power generation and transport) face an important common challenge and *'will have to work hand in hand to find and implement solutions to support e-mobility at regulatory, technological and implementation levels'*.
– On 29 September, the Competitiveness Council (Internal market and industry) discussed the impact of the 'Fit for 55' package on the economy and industry.[18] Broadly agreeing that *'the availability of affordable decarbonized energy is one of the preconditions for the success of Fit for 55',* the ministers emphasized the importance of the CBAM which should prevent the risk of carbon leakage and avoid distortion of competition. Interestingly (though not surprising), several delegations pointed at the challenges for the automotive industry and the need to avoid that the green transition will increase the burden on small- and medium-sized enterprises.
– In its meeting on 5 October, the Economic and Financial Affairs Council (ECOFIN) approved conclusions on climate finance (ahead of COP26), emphasized the continued strong support from the EU and its Member States for the implementation of the goals of the Paris Agreement, and committed to further accelerating efforts in line with the Green Deal, as well as on the basis of the European Climate Law that requires the EU to reduce greenhouse gas emissions by at least 55% by 2030 from 1990 levels and to be climate-neutral by 2050.[19]

In its report of 22 November 2021, the Presidency of the Council, presented an overview of progress of the 'Fit for 55' package of legislative proposals.[20] The Presidency states (in paragraph 12 of the overview) that, due to the huge number and size of the proposals in the package, the complexity and interlinkages, as well as their political significance, work on most files is still at a rather early stage. Delegations have been seeking clarifications from the Commission and requested more information on the role and contribution of the individual proposals to the overall community-wide ambition of achieving the net emission reduction target of 55%. According to paragraph 13 of the overview, the delegations need more time to fully assess the proposals put on the tables of the Environment and ECOFIN Councils. These proposals, in particular the introduction of a CBAM and the revision of the ETD, will be dealt with by respectively a dedicated Ad Hoc Working Party (CBAM) and the Working Part on Tax Questions (Indirect Taxation – Excise Duties/Energy Taxation). In its meeting on 7 December 2021, the ECOFIN Council *'took note without discussions'* of the Presidency report of 22 November.[21]

4 Closing remarks

The great ambitions and good intentions of the UNFCC and the EU to speed up the process of achieving a reduction in CO2 emission of 45% (the global UNFCCC target) and 55% (the EU target) and achieving the common target of net-zero emissions in 2050 require a sense of political urgency. Within one year, at the COP27, reports on progress must be presented by all parties, including the EU.

This means that the 'Fit for 55' package, proposed by the EC, should be adopted before November 2022. At this moment, the outcome of the informal and preliminary discussions on 'Fit for 55' in the four Councils is 'careful positive' but quite vague and not yet detailed, of course. The legislative process needs time to for getting more detailed information on the proposals, their interlinkages, and the assessment of their impact on climate change and the economy. The impact of the EU 'Fit for 55' proposals will depend on the 'energy mix' in the various EU Member States. Some of them are less dependent on fossil fuels, others are highly dependent on such fuels and may expect problems for their secure (fossil and renewable) energy supply when speeding up their

16 *See* https://slovenian-presidency.consilium.europa.eu/en/news/environment-ministers-at-a-meeting-in-slovenia-discuss-the-fit-for-55-package-and-the-cop26-international-climate-change-conference/ (accessed 11 Dec. 2021).

17 *See* https://slovenian-presidency.consilium.europa.eu/en/news/transport-and-energy-ministers-discuss-meeting-decarbonisation-targets-in-the-transport-and-energy-sectors/ (accessed 11 Dec. 2021).

18 *See* https://www.consilium.europa.eu/en/meetings/compet/2021/09/29/ (accessed 11 Dec. 2021).

19 *See* https://data.consilium.europa.eu/doc/document/ST-12203-2021-INIT/en/pdf (accessed 11 Dec. 2021).

20 *See* https://data.consilium.europa.eu/doc/document/ST-13977-2021-INIT/en/pdf (accessed 11 Dec. 2021).

21 *See* https://www.consilium.europa.eu/en/meetings/ecofin/2021/12/07/ (accessed 11 Dec. 2021).

energy transition. Even in a new, greener, energy mix, sufficient energy (and in particular electricity) should be available on demand.

States will also be aware of the pressure caused by an agreed timeline for achieving an agreed target for the reduction of greenhouse gases. In this respect, the decision of the Netherlands Supreme Court in the Urgenda Climate Case (2019)[22] is interesting. In this case, the Supreme Court ruled that, pursuant to Articles 2 and 8 of the European Convention on Human Rights (ECHR), the State is obliged to achieve a reduction of greenhouse gases originating from Dutch soil by the end of 2020 by at least 25% compared to 1990, due to the risk of dangerous climate change that could have a severe impact on the lives and welfare of the residents of the Netherlands. The Urgenda Case has led to similar suits in other countries, including Belgium, France, Ireland, Germany and the UK. In 2021, another Dutch environmental group 'Milieudefensie' was successful in a civil case before the The Hague District Court who ordered an individual company, Royal Dutch Shell plc., established in The Netherlands, to reduce the CO2 emissions of the entire Shell group (word-wide) by net 45% in 2030, and further to net-zero in 2050 (in line with the Paris Agreement), through the Shell group's corporate policy.[23] An unprecedented judgment that may trigger more similar court cases also outside The Netherlands.

As regards the proposed CBAM, before such instrument can be introduced, the EU will have to enter into detailed discussions with the World Trade Organisation (WTO). In his speech to the European Economic and Social Committee public hearing on 6 September 2021,[24] WTO Deputy Director General Jean-Marie Paugam started by stating that, in principle, nothing in the multilateral trade rules precludes the implementation of an ambitious environmental policy by WTO members, be it on the condition that they do not constitute unjustifiable discrimination or disguised protection. Emphasizing that his views on the CBAM proposal are still very preliminary, he indicated that, as long as there is no globally agreed uniform carbon price by which we could reach the Paris Agreement goals, other instruments may be required to avoid 'carbon leakage', such as a CBAM. Yet, Paugam pointed at some issues in the proposed CBAM that *'could be contentious and complicated in the WTO context'*. Issues such as how to calculate the carbon content of the imports from third countries and how to take into account the policies adopted by third countries from which imports originate to mitigate climate change. His call for further refinement in future dialogues makes clear that, for meeting the scheduled date for the CBAM to come into force (1 January 2023), a positive outcome of the dialogue on the subject between the EU and the WTO would be necessary.

As regards the 'revision' of the ETD, one could better speak of a fundamental restructuring of the EU framework for the taxation of energy products and electricity.

It is too early to estimate the impact of this 'tax instrument' on the economy of the EU Member States as well as on global warming.

Referring to the above-mentioned overview of Presidency of the Council of the EU (22 November 2021), notably as regards the work to be done by ECOFIN on CBAM and the ETD, and the outcome of the ECOFIN meeting (7 December 2021), I think the chance of being able to present a Council decision on these two proposals before COP27 is very small. Anyway, let's see how fast we can drive on the bumpy road to carbon neutrality.

22 *See* https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2019:2007 (accessed 11 Dec. 2021) (English text). The Dutch environmental group 'Stichting Urgenda' had sought a court order directing the State of The Netherlands to reduce the emission of greenhouse gases in accordance with the agreed target and timeline.

23 *See* https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBDHA:2021:5339 (accessed 11 Dec. 2021) (English text). Shell has agreed that urgent action is required and stated it will accelerate its transition to net-zero emission, but it will appeal because it finds a judgment against a single company not effective.

24 *See* https://www.wto.org/english/news_e/news21_e/ddgjp_16sep21_e.htm (accessed 11 Dec. 2021).