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Carbon Market Watch

Carbon Market Watch reaction to leaked 2030 Council Conclusions

On 23 and 24 October 2014, EU's heads of state will determine Europe's future action to avoid dangerous global temperature rises. At this important date, they will decide whether to follow the European Commission's proposal to reduce 40% domestic greenhouse gas (GHG) emission reductions below 1990 levels by 2030[i].

The proposed target of 40% GHG emission reductions is not nearly enough to put Europe on track towards its decarbonisation objective of 80-95% reductions by 2050. Moreover, technical loopholes in the current climate framework have accumulated to a 4 billion hot air bubble which threatens EU's future climate ambition. Without immediate and urgent action, this hot air bubble would effectively cause that the actual emissions reductions under a 40% GHG reduction target may be as low as 26%[ii].

A first leaked draft of the 2030 Council Conclusions[iii] confirms this threat. The leak offers a first picture of possible outcomes of the Council meeting. Notably, the leaked document suggests:

1. **Banking "phantom pollution rights"** = Turning the proposed 40% GHG target into 26%!
2. **Allowing offsetting with trees** = Offsetting permanent emission reductions with temporary CO_2 storage
3. **Dynamic allocation of free pollution permits** = Increasing subsidies to industry instead of having them pay to pollute
4. **Inclusion of transport in the EU ETS** = Inventing an alibi to do nothing to reduce transport emissions

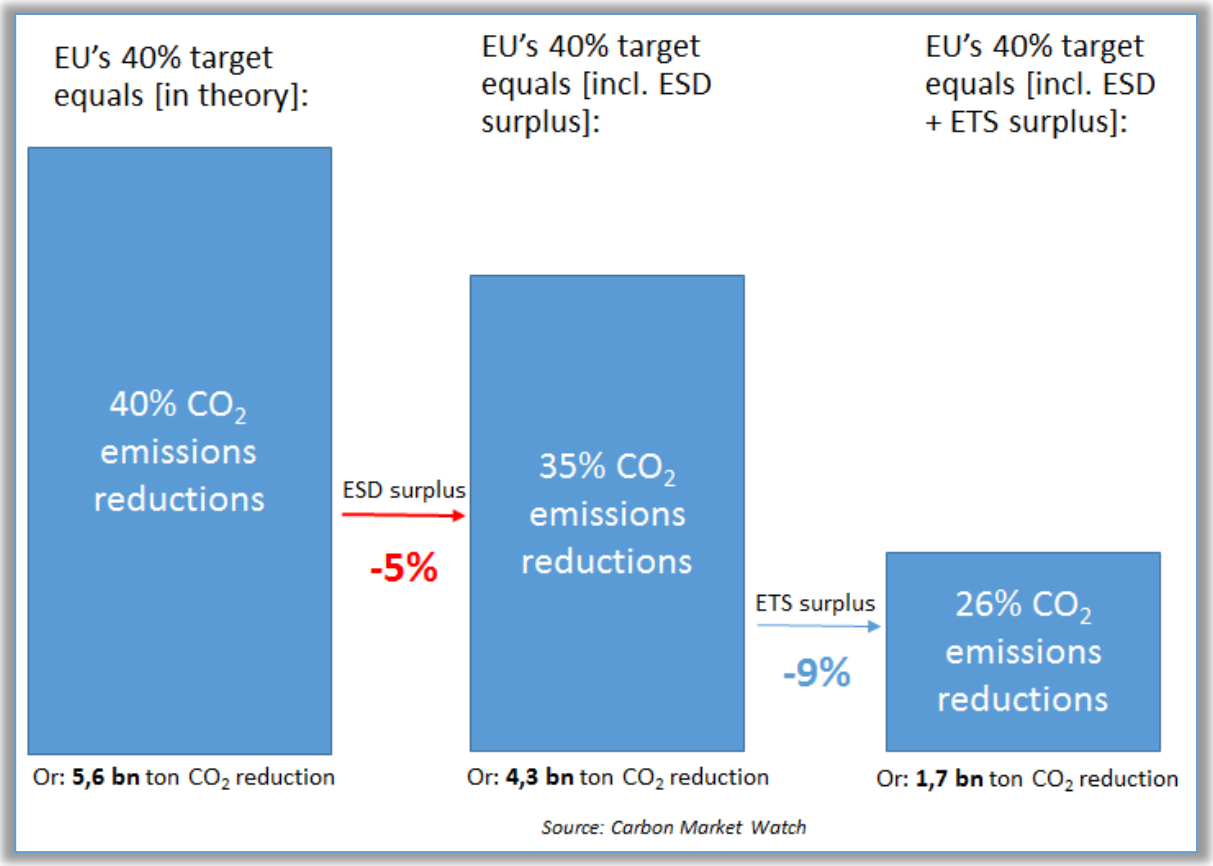
Below is a first reaction to what the leaked draft text would mean for the future EU climate framework:

1) Banking "phantom pollution rights" = Turning the proposed 40% GHG target into 26%!

The leaked Council conclusions read:

6. *In order to ensure cost-effectiveness of the collective EU effort, flexibility in achieving the targets in the non-ETS sector will be significantly enhanced, through i.e. increased carry forward of overachievements and transfers among the Member States."*

This can be interpreted as a direct reference to the EU's hot air bubble which is a result of the surplus pollution permits generated by EU's climate targets set in 2007 when EU's heads of states agreed to reduce EU's emissions by 20% in 2020. The hot air bubble is estimated to equal almost 4 billion emission allowances and is currently putting a dark shadow over the EU's future climate targets because it could be directly transformed into future rights to pollute.



The 4 billion rights to pollute are distributed between the two policy instruments Emissions Trading Scheme (EU ETS)[iv] and the Effort Sharing Decision (ESD)[v].

While the question how to address the surplus under the EU ETS (equaling 9% of the EU's GHG target) is currently discussed as part of the Market Stability Reform (MSR) proposal in the European Parliament[vi], the fate of the pollution permits under the ESD (equaling 5% of the EU's GHG target) are in the hands of our heads of states.

It is predicted that the greenhouse gas emissions will remain below the Effort Sharing targets in each year during the 2013-2020 period. This leads to a surplus in the ESD equal to around 600 million tons of CO_2-eq[vii]. The build-up of surplus is the outcome of weak targets and will not be the result of additional reduction efforts.

EU member states can also purchase more than half of their overall reduction obligations through carbon credits from offsetting projects in developing countries. This means that member states are allowed to use up to 750 million offsets until 2020[viii].

This means that by 2020 there could be a hot air bubble equal to 1,35 billion tonnes of CO_2-eq in the ESD as a result of weak targets and the use of international offsets.

Recommendation: The leaked 2030 Council Conclusions indicate the wish to carry-over the surplus into the 2030 climate framework. To avoid that these 5% of phantom rights to pollute are undermining the 40% target, heads of state should instead agree to disallow the banking of surplus.

2) Allowing offsetting with trees = Offsetting permanent emission reductions with temporary storage

The leaked Council conclusions read:

13. The EC recognises specific circumstances in the Member States, in particular as regards limited possibilities to reduce emissions in some sectors and agrees that countries with exceptionally high emissions in the agriculture sector [i.e. over 40%] should be allowed to offset these emissions with the reductions from afforestation.

This paragraph suggests to include the emissions from removals related to land use, land use change and forestry (LULUCF) which have so far been treated outside the EU's 2020 climate framework. This loophole seems tailored to certain Member States with a relatively large share of agriculture emissions, in particular Ireland. Preliminary estimations show that Ireland could offset around 3 million tonnes of CO_2-eq through additional afforestation[ix].

This can get dangerous because LULUCF emissions and removals are characterised by potentially large annual fluctuations and long-time horizons, while there are uncertainties relating to data reliabilities. These characteristics make the sector unfit for inclusion in the EU ETS or the ESD that have an annual compliance cycle. Planting trees in order to displace efforts in sectors where major emission reductions are needed is risky because the forest sector is a big carbon sink where the permanence of stored carbon cannot be guaranteed.

Recommendation: The leaked 2030 Council Conclusions opens the door for land use offsets from potentially large forest sinks. To avoid that land use offsets displace action in other sectors of the economy, the land use sector should be placed in a separate pillar without any possibility of offsetting.

3) Dynamic allocation of free pollution permits = Increasing subsidies to industry instead of having them pay to pollute

The leaked Council conclusions read:

14. The existing policy framework for industrial sectors most at risk of carbon leakage will continue until 2030 in order to ensure long-term planning security, a system of free allocation with a better focus on sectors really affected by the risk of carbon leakage will be developed. This system will be periodically updated to allow for better alignment with actual production trends in sectors, while fully maintaining the incentives of the ETS to innovate and reduce emissions and keeping the administrative costs low.

Under this paragraph it is proposed to continue with the current practice of subsidising industry's pollution by giving them free emission allowances. Industries deemed at risk of carbon leakage will receive even more free pollution permits than today as allocation will be based on actual production and total allocation will not be subject to an industry cap anymore. This assumes a significant transfer of wealth from taxpayers to industry because the auctioning revenues of Member States will be reduced. This approach brings EU taxpayers at risk of paying industry an extra €130 billion worth of free pollution permits to compensate for a problem for which there is no proof[x].

Recommendation: The leaked 2030 Council Conclusions propose to dynamically allocate free pollution permits to industry after 2020. To avoid subsidising heavy emitters for their pollution, the EU heads of state should auction permits to reward efficiency while only providing support to the frontrunners that want to invest in low-carbon solutions in Europe.

4) Inclusion of transport in the EU ETS = Inventing an alibi to do nothing to reduce transport emissions

The leaked Council conclusions read:

12. The Commission, in collaboration with interested Member States, will swiftly explore modalities to facilitate the unilateral inclusion of fuels used in the transport sector by a Member State into the EU ETS in line with the modalities foreseen in the ETS Directive.

This paragraph opens the door for including transport fuels, currently covered by the Effort Sharing Decision, into the EU ETS. This puts the decarbonisation of the transport sector at risk as the €5 carbon price under the EU ETS will fail to incentivise increased public transport, advanced biofuels or electric vehicles. It allows Member States to wipe their hands clean of getting to a more efficient transportation system that would bring their citizens benefits like cleaner air and reduced noise, while cutting traffic congestion. Inclusion of transport in the EU ETS would furthermore undermine more effective European and national policies like the CO_2-standards for cars that lower fuel consumption or fuel taxation.

Recommendation: The leaked 2030 Council Conclusions opens the door for the inclusion of transport fuels in the EU ETS. To avoid putting the decarbonisation of transport at risk, the transport sector should remain under the Effort Sharing Decision, thereby allowing the European Union and individual Member States to put in place effective policies.

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[i] EC (2014), A policy framework for climate and energy in the period from 2020 to 2030, see here
[ii] Calculation with the assumption that the 3.95 billion surplus is used for compliance in the 2020-2030 period, and assuming that EU-28 1990 emissions equaled 5.626 million tons of CO_2 (EEA, 2014).
[iii] See here for the leaked Council Conclusions
[iv] For more information on the EU ETS, see our policy briefing "What's needed to fix the EU's carbon market" here
[v] For more information on the ESD, see our policy briefing "Tackling 60% of the EU's climate problem" here.
[vi] Under the EU ETS it is already possible to bank the unused oversupply of carbon allowances for use in the post-2020 period. This means that the 2.6 billion hot air bubble under the EU ETS will be automatically carried-over in the 2030 framework, unless these surplus allowances are permanently retired. To completely deflate the 2.6 billion hot air bubble under the EU ETS, the EU heads of state should agree to permanently retire 2.6 billion surplus ETS allowances.
[vii] European Commission (April 2014), Technical Annex to Kyoto Ambition Mechanism Report
[viii] European Environment Agency (2013). Trends and projections in Europe 2013
[ix] Sustainable Energy Ireland (2009), Ireland's Low-Carbon Opportunity, see here.
[x] For more information on "dynamic allocation", see our carbon leakage rebuttal here