Carbon Market Watch

The 2030 Effort Sharing Regulation

How can the EU's largest climate tool spur Europe's low-carbon transition?

Carbon Market Watch Policy Briefing
September 2016

Executive summary

In summer 2016, the European Commission presented a legislative proposal for the Effort Sharing Regulation (ESR) for the 2021-2030 period. The ESR sets national emission reduction targets for the EU Member States for the transport, buildings, agriculture and waste sectors.

Covering 60% of the EU's total greenhouse gas emissions, it is a centerpiece of Europe's efforts to implement the goals of the Paris climate change agreement. If designed correctly, the ESR can help secure a climate friendly transformation of our society and lead to more livable cities, cleaner air, reduced energy poverty and the creation of jobs. These benefits will be the result of the EU and national policies that are implemented to meet the targets set by the ESR.

However, the current 2030 target of reducing emissions by 30% in the sectors not covered by the EU Emissions Trading System (EU ETS) is too low to keep global warming in check. Moreover, the introduction of loopholes would mean that in reality emissions could fall by much less than the 30% by 2030, potentially only by 23%. This means that countries would meet their targets on paper, but not necessarily in practice.

The ESR offers different flexibilities and trading options to make it less costly to comply with the targets. Flexibilities amount to loopholes when they undermine the low-carbon transition of the non-ETS sectors. Allowing countries to use forestry or ETS credits for compliance instead of actually reducing emissions in the ESR sectors, undermines not only the environmental integrity of the proposal but also the climate friendly transition of the European economy.

Furthermore, the current starting point of the ESR does not accurately reflect the actual 2020 emissions and rewards countries that fail to meet their 2020 target, leading to more greenhouse gasses being emitted between 2021 and 2030.

This policy brief analyses the Effort Sharing proposal and provides recommendations to policymakers on how to improve it.

Key recommendations for the 2030 Effort Sharing Regulation

- **Increase ambition in line with EU's long-term objectives** by including a trajectory to at least 95% emission cuts by 2050 supported by, at a minimum, 45% reductions in the non-ETS sectors by 2030.
- **Include 5-yearly review and ratchet mechanisms**, allowing the EU and national climate targets to be upwardly revised every five years.
- **Strengthen compliance** by introducing annual compliance checks and planning provisions that specify how the decarbonisation of the transport, building, agriculture and waste sectors will take place.
- **Start counting from the right point,** either on the basis of the actual 2020 emissions, or the 2020 targets, whichever is lower.
- **Close loopholes that undermine the transition** to avoid the risk of not achieving the 2030 target of 30% emission cuts in non-ETS sectors:
    - Prohibit surplus ETS allowances as they undermine climate actions in non-ETS sectors
    - Reject the use of forestry credits that allow more greenhouse gas emissions elsewhere
    - Do not give lower-income states a pollution bonus in 2021 that delays their transition

Introduction

The EU's 2030 climate framework includes three main pieces of legislation to reduce greenhouse gas emissions:

1. The EU's Emissions Trading System (EU ETS) that covers emissions from large installations in the power and industrial sectors, as well as aircraft operators.

2. The Effort Sharing Regulation (ESR) that sets national emission reduction targets for sectors not covered by the EU ETS.

3. The land use, land use change and forestry (LULUCF) Regulation to incentivise climate-friendly land use.

On 20 July 2016, the European Commission published a proposal to reduce the emissions in non-ETS sectors between 2021 and 2030. It is now up to the Members of the European Parliament and representatives of the Member States to amend and adopt this legislation. This policy brief analyses the Effort Sharing proposal and provides recommendations on how to improve it.

Why the Effort Sharing Regulation matters

In the Paris Agreement of December 2015, all countries agreed to take action on climate change, in order to limit global warming to well below 2°C and to pursue efforts to limit the temperature rise to 1.5°C. Europe's contribution to this global effort will be determined, in large part, by the Effort Sharing Regulation that covers the majority of the EU's total emissions in the post-2020 period.

While the low-carbon transition of the transport, agriculture, buildings and waste sectors comes with a price tag, it will result in clear benefits for citizens such as cleaner air and better health that outweigh the costs[1]. The Effort Sharing Regulation should support and incentivise this transition.

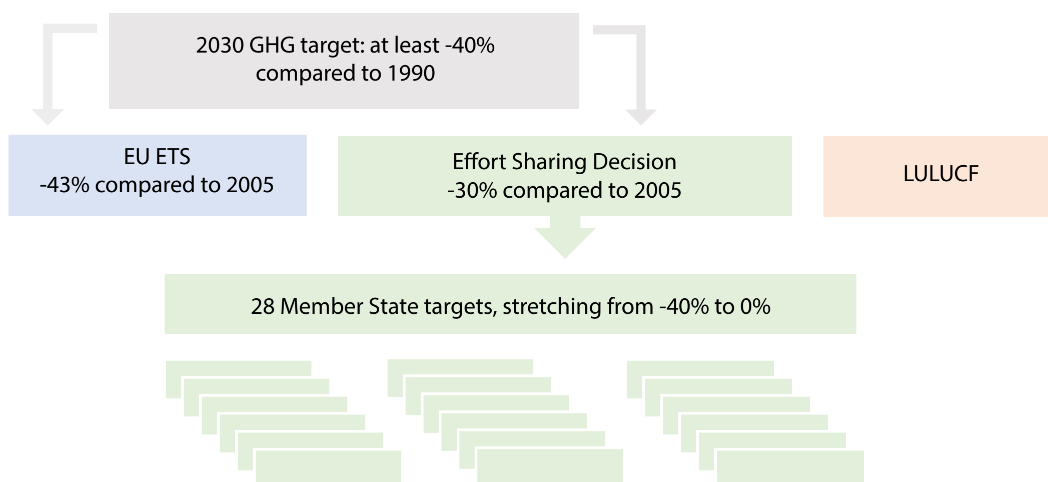
In the non-ETS sectors, the benefits are related to the implementation of new EU and national measures that reduce emissions.

They could lead to more livable cities with less noise and air pollution as a result of better public transport, cycling and walking infrastructure and the uptake of electric and cleaner vehicles. In the agriculture sector, connecting farmers and consumers can lead to better food quality and dietary changes such as less meat consumption, while reducing water pollution. Finally, investments that lower the heating demand of the building stock in the EU provide numerous benefits to citizens seeking more comfortable, affordable and healthier homes, and can create jobs in a sector that was particularly hard hit by the economic crisis.

These tangible benefits are dependent on an effective Effort Sharing Regulation that promotes the uptake of climate efforts in the sectors it covers in line with the Paris Agreement objectives.

The 2030 Effort Sharing Regulation in short

The Effort Sharing Regulation will be the EU's largest climate policy instrument after 2020 as it will regulate about 60% of our total greenhouse gas emissions – those from sectors including transport, agriculture, waste and the heating and cooling of buildings. The predecessor of the ESR is the Effort Sharing Decision (ESD) which currently regulates the non-ETS emissions in the 2013-2020 period. Under the ESD, the 2020 target was collectively met already in the first compliance year in 2013.



The Effort Sharing Regulation will set national emission reductions targets for each Member State, generally based on the country's wealth as measured by GDP per capita. The wealthiest Member States need to reduce their emissions by 40% below 2005 levels by 2030 and the poorest is allowed to stabilise its 2005 emissions by 2030. Those national targets add up to an overall EU ESR reduction target of 30% below 2005 emissions levels by 2030. The EU's ESR and ETS targets together are expected to achieve the overall climate target of at least 40% less emissions domestically by 2030 compared to 1990 levels.

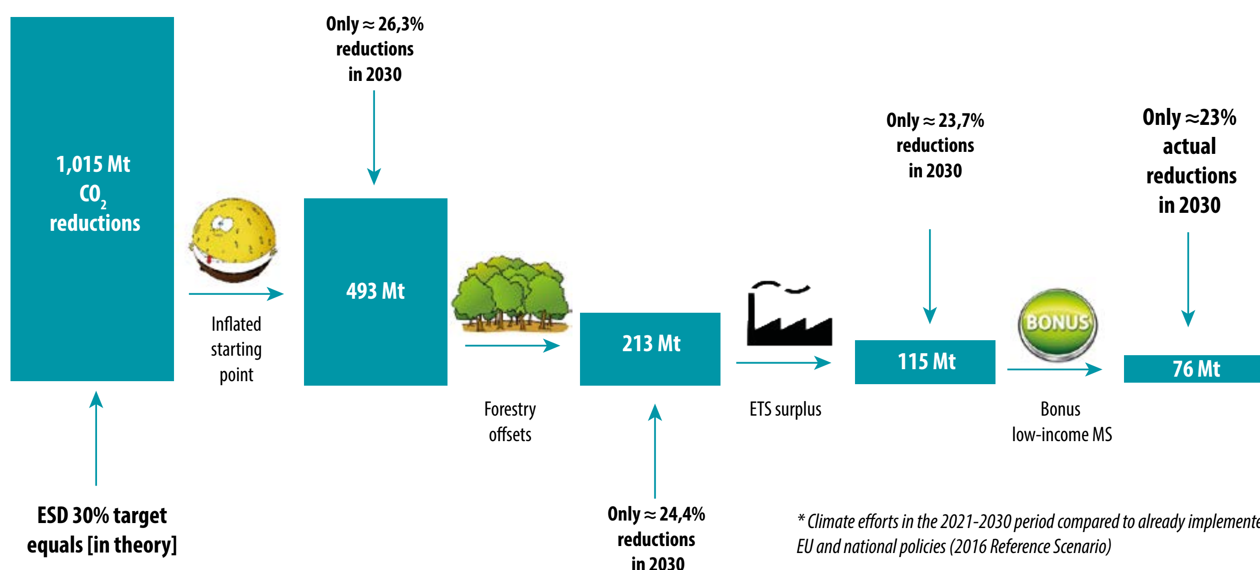
The impact of loopholes

In theory, the Effort Sharing Regulation is expected to deliver emission cuts equal to around 1,000 million tonnes of CO2 compared to already adopted EU and national measures[2]. However, a full use of different flexibilities, higher starting point and a bonus for lower-income states could lead to emission reductions equal to only 75 million tonnes of CO2 in total between 2021 and 2030.

In comparison, new CO2 standards for cars and vans for the years 2025 and 2030 can achieve these reductions in just one single year, which means that more ambition is possible.

These loopholes therefore put the delivery of the EU's 2030 target for the non-ETS sectors at risk. Rather than reducing emissions by the promised 30% by 2030, emissions could in reality be reduced by merely 23%.

IMPACT OF LOOPHOLES ON THE EU'S CLIMATE EFFORTS IN THE NON-ETS SECTORS



Flexibilities versus loopholes

To make it less costly to comply with their emission reduction targets, Member States are allowed to use flexibilities. These are similar to the current ESD flexibilities and include inter alia:

- Any overachievement of the target in a certain year can be banked to a future year or transferred to other Member States. However, the surplus from the 2013-2020 period which is expected to accumulate to over 1,500 Mton CO_2[3] cannot be used for compliance under the 2030 ESR as any carry-over would seriously jeopardise the achievement of the 2030 target.

- Member States can borrow from the following year or transfer to another Member State up to 5% of their annual target.

In addition, two new flexibilities are included in the ESR proposal. These new flexibilities amount to loopholes as they undermine the low-carbon transition of the non-ETS sectors:

1. **The one-off ETS flexibility.** Each year, certain Member States[4] are entitled to use ETS allowances up to the equivalent of 2% or 4% of their 2005 non-ETS emissions. This means that up to 100 million ETS allowances can be used during the period from 2021 to 2030 to offset emissions in e.g. the agriculture or transport sector. Countries need to communicate before 2020 if they want to make use of this flexibility.

The ETS allowances will then annually be subtracted from the country's auctioning volumes, leaving it with less auctioning revenues to invest in climate measures. For example, if Luxembourg decided to make full use of this loophole to offset its high transport emissions, it would lose out on more than 40% of its ETS auctioning volumes. Ireland would lose out on 20-40% of its ETS auctioning volumes if it fully uses this loophole in order to avoid having to mitigate its relatively high agriculture emissions[5].

2. **The LULUCF flexibility**. Each year, all Member States are entitled to use a certain amount of forestry and land use (LULUCF) credits if these sectors absorb more carbon from the atmosphere than they emit. This loophole was pushed for by countries that wanted to avoid taking mitigation efforts in the agriculture sector. The proposal stipulates that credits can only make up a domestic shortfall and cannot be traded with other countries.

   tIn total, up to 280 million LULUCF credits are currently allowed to be used during the 2021-2030 period to offset emissions in the ESR sectors. When fully exploited, this would be equal to adding over 260 million cars on our roads[6]. Credits can be generated from planting trees (afforestation) or from properly managing cropland and grassland. Relying on credits from planting trees is particularly troublesome, as the carbon removals can be reversed at any time when trees are cleared and burned.

The EU's 2030 climate target has to be met by domestic measures only, therefore the use of international offsets is no longer allowed in the ESR.

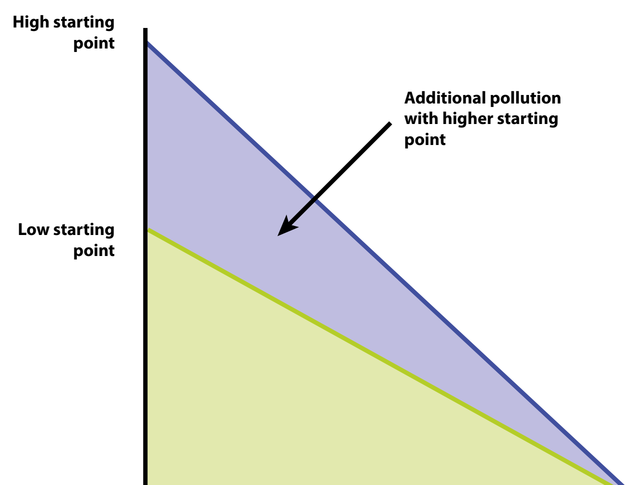
Carbon budgets explained

Climate targets are usually presented as a percentage of emission reductions to be achieved by a certain point. However, what matters for the atmosphere, in addition to the value of this end point, is how much pollution is released along the way. Once greenhouse gases are in the atmosphere, they stay there for a long time. Therefore, the fewer total emissions are released over time, the lower the CO2 concentration and the smaller the effect on global temperature rise.

The starting point

The Commission proposes to start the ESR on the basis of a country's average 2016-2018 emissions. However, in five countries[7] these emissions are expected to be higher than their 2020 targets. These countries are also expected to miss their 2020 targets. Under the current proposal, these Member States are given a less stringent starting point in 2021 than their 2020 target, which rewards non-compliance.

A lower starting point will result in a lower amount of pollution in the 2021-2030 period and a lower concentration of carbon in the atmosphere. The least emissions are released when the starting point of the ESR is set on the basis of a country's 2020 emissions, or on the basis of the country's 2020 target, whichever is lower. This would reduce the non-ETS carbon budget by around 500 million tonnes of CO_2 compared to the current proposal.



Pollution bonus for lower-income Member States

In the ESR, lower income countries benefit from more lenient climate targets, and some can further profit from a higher target for the year 2021 compared to other countries. The 2021 targets for these twelve countries are set on the basis of their average 2016-2018 emissions but further increased by a total of 39 million tonnes of CO2. This is said to compensate them for the amount by which they are still allowed to increase their emissions between 2017 and 2020 under the current Effort Sharing Decision. Unfortunately, this bonus further delays their transition to climate friendly societies.

Targets and penalties

The ESR establishes binding targets for each year in the 2021-2030 period. In case of non-compliance, Member States are faced with an automatic penalty which takes into account the environmental cost of delaying emission cuts: the excess emissions multiplied by a factor of 1,08 are added to the emissions of the following year so that the target becomes more stringent. Although the ESR establishes binding annual

targets, the compliance checks and penalties will only take place every 5 years, in 2027 and 2032. Until the country is in compliance again, it cannot trade its allowances or surplus with other Member States.

In addition to the 5-yearly compliance checks, the Commission will annually evaluate the progress of the Member States. When this progress deviates from the country's annual target, the Member State will need to prepare a corrective action plan with additional measures to be implemented.

Planning for the future

The Effort Sharing Regulation sets the pace of decarbonisation of the sectors it covers, in particular of the transport, agriculture, buildings and waste sectors. These sectors will need to undergo radical changes both in the short and longer term in order to meet the EU's 2050 climate objectives.

The ESR should incentivise the low-carbon transition, not only up to, but also beyond 2030. This means that robust planning and reporting requirements should be made with the EU's 2050 objective as a reference point.

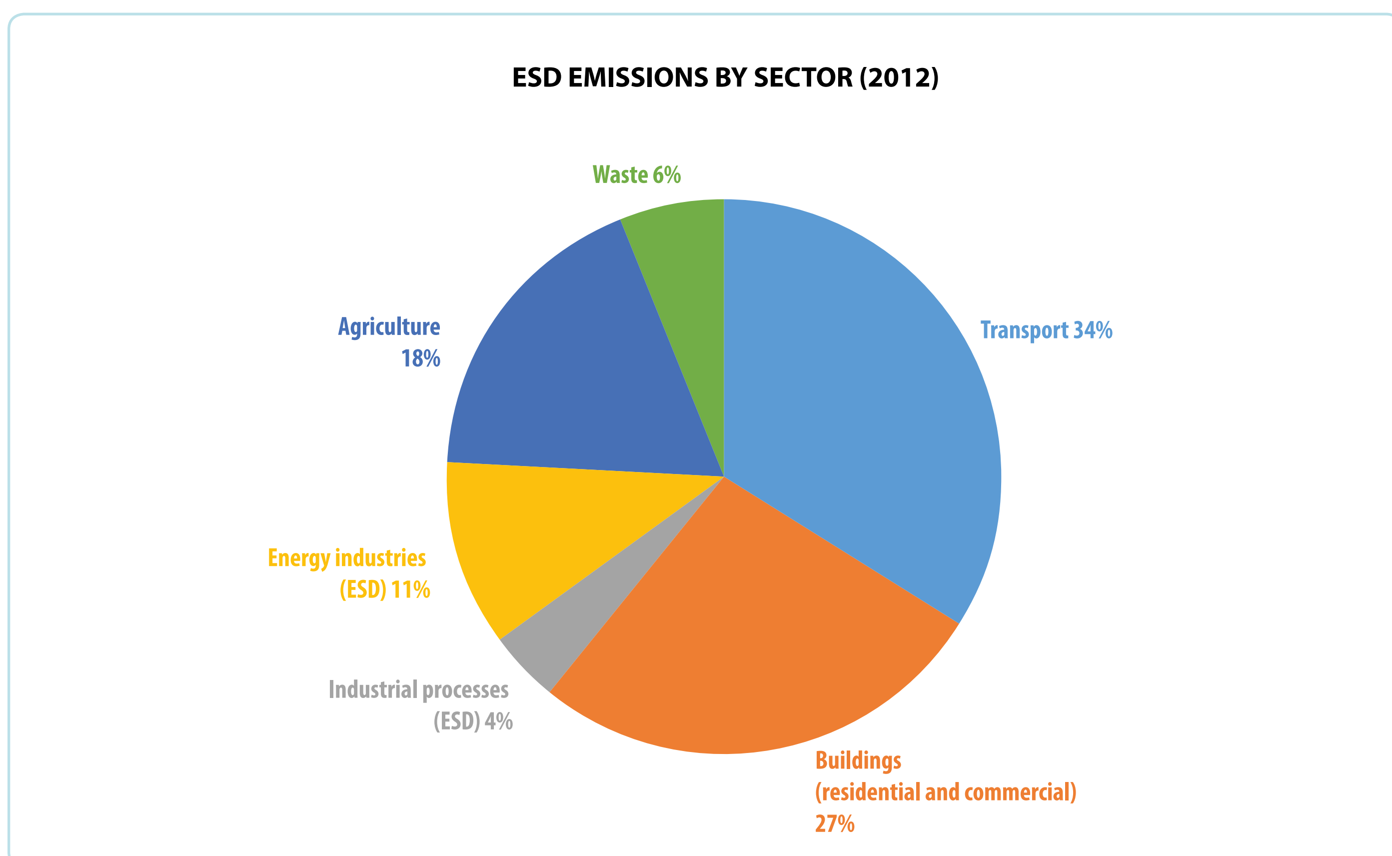
Under the current proposal, the Commission shall review the ESR and its contribution to the goals of the Paris Agreement by the end of February 2024, and every five years thereafter. However, it does not include a pathway towards the 2050 objective, or planning and reporting measures to help achieve the transition towards this long-term goal.

The ESR requires countries to annually report their greenhouse gas emissions and intention to make use of the flexibility to trade allowances[8]. Moreover, information on implemented and planned national policies and measures, as well as emissions projections need to be reported bi-annually[9].

Sectoral policies to meet the ESR targets

While the ESR sets an overall greenhouse gas reduction target for the sectors it covers, it does not specify where, how and with what policies a country should reduce its emissions. The choice of measures is therefore the responsibility of each Member State, although existing and new EU policies help Member States achieve their targets.

These policies are necessary to overcome the specific barriers to implement climate efforts. For example, measures to reduce transport emissions are in general relatively expensive if not tackled by fuel standards or investments in infrastructure. On the other hand, energy saving measures are often faced with non-financial barriers such as lack of information or split incentives between building owners and tenants. This shows that even if the overall greenhouse gas emissions are governed by the Effort Sharing Regulation, it will not be possible to meet the targets without developing policies within the specific sectors.



Key recommendations for the 2030 Effort Sharing Regulation

Increase ambition in line with EU's long-term objectives

The Effort Sharing Regulation must set Europe on a cost-effective path to reach the goals of the Paris Agreement and contain a trajectory to reach an overall greenhouse gas emission reduction target of at least 95% by 2050 supported by, at minimum, a 45% reduction in the non-ETS sectors by 2030.

Include 5-yearly review and ratchet mechanisms

In light of the future scientific assessments and the Paris Agreement requirements, there needs to be a mechanism in the ESR for the EU and its Member States to upwardly revise the targets every five years to avoid dangerous global warming. The 5-yearly reviews of the ESR should hence also include the specific possibility of increasing the EU's and national climate targets as well as the option for Member States to cancel allowances.

Strengthen compliance

Under the ESR, compliance checks only occur every five years and penalties for possible non-compliance will only be applied in 2027 for the first time. Annual rather than five-yearly compliance checks would be more effective to ensure that the annual targets are met. The ESR should furthermore establish planning provisions so that the EU and its Member States establish policies and measures that result in the low-carbon transition of all non-ETS sectors.

Start counting from the right point

In the ESR proposal, the starting point is set on the basis of the average 2016-2018 emissions. As emissions are expected to decrease between 2016 and 2020, this inflates the total allowable carbon budget. Countries that will not meet their 2020 targets are furthermore rewarded for non-compliance. Starting on the basis of the actual 2020 emissions, or the 2020 targets, whichever is lower, can lead to additional reductions equal to around 500 Mton CO_2-eq.

Prohibit surplus ETS allowances that undermine climate action in non-ETS sectors

The proposed ESR allows nine countries to auction less ETS allowances to meet their climate targets. When deciding to make use of this flexibility, these countries will forego significant amounts of scarce financial resources. Given the huge oversupply in the EU ETS, the reduction of 100 million allowances will not help to reduce the ETS emissions. At the same time, it allows more emissions in the non-ETS sectors, leading to higher EU overall emissions. The use of ETS allowances in the ESR should not be allowed, or at a minimum, a discount factor of 4:1 should be introduced to discourage the use of this loophole.

Reject the use of forestry credits that allow more greenhouse gas emissions elsewhere

All countries are allowed to use a total of 280 million credits from planting trees and managing cropland and grassland to offset ESR emissions. Relying on non-permanent forestry credits is dangerous since the carbon removals can be reversed at any time when trees are cleared and burned. All sectors, including the agricultural sector, must embark on the climate friendly transition. The use of land use credits should not be allowed, or at a minimum, credits in the ESR to compensate for agriculture's non-CO2 emissions should be restricted to credits from activities with the most robust accounting rules; management of cropland and grassland. The credits from forestry should not be allowed.

Do not give lower-income states a pollution bonus in 2021 that delays their transition

Due to reasons around fairness, lower-income Member States have been distributed less stringent targets than richer countries. In addition, they will receive a starting point bonus that allows them to emit 39 Mton CO_2 more in the year 2021. This bonus further delays the transition to climate friendly societies.

1 Additional total system costs of the EU's 2030 climate target of €2-22 billion per year, compared to reduced health damage and air pollution costs of €7.2-34.8 billion per year (EC 2030 framework impact assessment).
2 The EU 2016 Reference Scenario, see here.
3 EEA (2015), Trends and Projections in Europe 2015 see here.
4 Belgium, Denmark, Malta, the Netherlands, Austria, Finland and Sweden: 2%. Ireland and Luxembourg: 4%.
5 See SWD(2016) 247 p. 68. Other countries will lose out on 5-10% of their auctioning volumes.
6 T&E (2016), see here.
7 Belgium, Denmark, Ireland, Luxembourg and the Netherlands
8 This reporting must be done by 15 January, from 2023 onwards.
9 This reporting must be done by 15 March from 2023 onwards.

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