

# Carbon Market Watch response to the EU consultation on the 2030 Effort Sharing Decision

*Submitted: 18 June 2015*

1. How can the availability and use of the two existing internal flexibility instruments under the ESD be enhanced to ensure cost-effectiveness of the collective EU-effort in 2021-2030:

- a) for banking and borrowing; and
- b) for AEA transfers among member states respectively.

As a general remark, Carbon Market Watch does not see the need to enhance the availability and use of flexibility instruments under the ESD as there are enough measures available in the transport, agriculture, building, and waste sectors in all the Member States to reduce emissions domestically. The need for intra-EU flexibilities can be significantly reduced simply by implementing additional mitigation policies both before and after 2020. Through early action, Member States can reduce the mitigation efforts needed after 2020 by around 1,000 Mt CO<sub>2</sub>-eq by implementing the planned additional measures of their own WAM projections (Oeko-institut, 2015). Similarly, new EU-wide policies for the post-2020 period have the potential to significantly reduce emissions from the transport, agriculture and buildings sector.

Any enhancement of existing flexibility instruments should under no circumstance lead to a reduction of the overall ambition level for the non-ETS sectors or to an increased risk of non-compliance.

#### **Banking:**

The possibility to bank unused annual emission allocations (AEAs) within the 2021-2030 period should remain unchanged, since it encourages early action.

Banking from the ESD I to ESD II (e.g. from 2020 to 2021) is not possible, since the Effort Sharing Decision states that the mechanism is only valid until 2020. The idea of carry-over of surplus into the post-2020 period was furthermore discarded by Member States ahead of the October 2014 council meeting. The reason for this is that the banking of surplus allowances to the post-2020 period would lead to a significant reduction of ambition and overall integrity of the EU's 2030 greenhouse gas emission reduction target. The EEA (2014) has estimated that Member States will have a surplus of 700 – 2,000 Mt CO<sub>2</sub>-eq by 2020 which if carried-over to the 2021-2030 period would lead to a significant reduction of EU's 2030 climate ambition and cause that the actual emissions reductions under the 30% ESD target may be as low as 16%.

#### **Borrowing:**

Borrowing from future years increases the risk of compliance problems at the end of the ESD period and delays mitigation action into the future. The level of borrowing should be restricted to the annual reduction effort in the 2030 ESD (±2% of 2005 emissions), and therefore be reduced to 2%.

The average 2% borrowing rate could be implemented as a higher percentage in the beginning of the commitment period, and a lower percentage towards the end of the period. These different levels of borrowing over time can help avoid the risk that Member States face troubles early in the 2020s in case policies to reduce non-ETS emissions have lead times.

#### **AEA transfers:**

The transfer of surplus AEAs is already unlimited and cannot be further enhanced.

Increasing the current 5% limit for AEA transfers is not a good idea since it can lead to compliance problems as it enlarges the risk of Member States not meeting their targets later in the commitment period. There are however other ways to enhance the availability and use of AEA transfers among Member States, for example by centrally auctioning a share of the overall annual AEAs or by introducing a clearing house for Effort Sharing projects.

With respect to the latter, is there need for more transparency in how Member States engage in AEA transfers? Could the current rules be further enhanced through more transparent reporting, the use of trading platforms, project-based mechanisms, auctioning, or through other means? Are there examples from other areas that could provide useful experience in designing a post-2020 transfer system?

Yes, there is a need for more transparency in how Member States engage in AEA transfers after. So far there has been no information on the details and prices of AEA transactions.

#### **Auctioning:**

Putting a price on carbon introduces the polluter-pays concept to the Effort Sharing Decision and increases the visibility of the costs of climate emissions in the national budgets. While this flexibility allows richer Member States to offset part of their emissions by purchasing an amount of AEAs at auction, it could also provide revenues to lower-income Member States to reduce more emissions domestically.

Auctioning should be introduced by auctioning a share of all annual AEAs by a central institution. The auctioning revenues should be earmarked for climate measures in the lower-income Member States to support the transition to climate friendly societies in these countries. Assuming that 30 million AEAs would be auctioned every year (approx. 1% of 2005 emissions under the ESD and half of the annual reduction effort), the total revenues during the 2021-2030 period could equal €9 billion (assuming an AEA price rising from €20/AEA in 2021 to €40/AEA by 2030).

A minimum selling price must be introduced to avoid a price that is too low to incentivize mitigation action in the non-ETS sectors. In years when the floor price is not met and the auction is cancelled, the AEAs that were put to auction must be cancelled as well.

#### **Project-based mechanisms:**

Intra-EU offsets have several benefits. They can help unlock mitigation potentials which might not have realised otherwise, for example due to a lack of financial or other resources and thereby catalyse action in Member States with more limited means to help avoid a lock-in of high carbon energy systems after 2020. This is important because the transition towards climate friendly societies can only succeed if all Member States are engaged in and take ownership of the transition, while EU leaders have proposed to take equity as the basis of the effort sharing principles which do not guarantee that all Member States in this transition.

Intra-EU offsets involve the private sector and may lead to more action in those Member States where the ESD targets are relatively easy to meet, since there might be little perceived interest for these governments to implement policies to reduce emissions beyond the target. Another advantage of involving the private sector is that governments usually try to minimize risks while the experience and knowledge of the private sector can be useful to find new opportunities to reduce emissions. Intra-EU offsets can also have spill-over effects in the host countries as local knowledge is enhanced and best practices can be developed.

The introduction of a clearing house that could broker and supply based on common EU rules and procedures yields the highest degree of harmonization and transparency. Experience with the Clean Development Mechanism (CDM) and Joint Implementation (JI) has shown that without specific selection criteria, a market-based mechanism will be most successful in identifying the lowest cost mitigation opportunities. Intra-EU offsetting under the ESD must therefore include selection criteria beyond prices to ensure only transformative projects that are strategically important for the transition to an efficient and renewable-based economy are targeted, such as deep renovation of buildings, development of sustainable, low-carbon agricultural practises and the initial uptake of electric vehicles.

In order to make sure that the host country also benefits from the emission abatement realised by effort sharing projects, part (10%) of the achieved reduction should stay with the host country and only 90% is transferred to the seller. In this way, the effort sharing projects contribute to the achievement of targets in both the buying and the selling Member States.

Intra-EU offsets under the ESD shall not be eligible for use under the EU ETS to ensure a clear separation of the two instruments so that problems from the one instrument cannot spill-over to the other thereby making both instruments less effective in driving down emissions.

2. On the basis of experience with the present set of rules on reporting, monitoring and corrective actions, which aspects should be maintained and which should be changed after 2020?

Please select one of the following:

- a) Keep it as it is: Annual reporting and annual compliance checks with existing corrective action;
- b) Annual reporting with biennial compliance checks with existing corrective action;
- c) Biennial reporting with biennial compliance checks and enhanced corrective action;
- d) Other (with explanation);

Annual reporting and annual compliance checks are essential to ensure that countries are on track to meeting their targets. Compliance with the ESD targets should be assessed in a credible, consistent, transparent and timely manner and this requires an annual review of Member States' greenhouse gas inventories to check if Member States are in compliance with their annually binding emission limits.

In addition, there should be biennial reporting of greenhouse gas emission projections and policies and measures in the 2021-2030 period, in line with the current rules as set out by the Monitoring Mechanism Regulation. This is essential to check if Member States are on track to meeting their ESD targets in the 2021-2030 commitment period, or if additional policies and measures at EU or national level are required. Biennial reporting on projections and policies and measures is also necessary to estimate the expected supply and demand for AEA transfers.

3. How can cost-effectiveness be reflected in a fair and balanced manner in adjusting individual ESD targets for Member States with a GDP per capita above the EU average? What can be the role of the one-time reduction through a limited amount of ETS allowances in achieving these Member States' ESD targets, while preserving predictability and environmental integrity?

How to set the 2021 starting point of the 2030 ESD is a relevant question for EU's overall future climate ambition. In order to set the right incentives, the starting point for each Member State should be the lower of the 2020 target and the Member State's average 2016-2018 emissions. A starting point solely based on the average 2016-2018 ESD emissions would favour Member States whose emissions are above their 2020 target and penalizes early movers.

Carbon Market Watch strongly opposes the ETS flexibility since it allows certain countries to offset their non-ETS emissions by buying surplus ETS allowances, which could lead to postponed action in the ESD sectors and overall higher emission levels in the EU until 2030. This is because the ESD emissions will increase until 2030 by the amount of incoming ETS allowances, while the decline of the ETS surplus will not have a significant effect on ETS emissions until 2030 due to the structural high surplus of ETS allowances until at least 2030. Governments are better off spending their scarce resources on mitigation measures in ESD sectors, which come with clear benefits

to citizens in terms of job creation, cleaner air and improved access to public transport means, rather than on buying surplus ETS allowances.

The 2030 council conclusions highlight that only Member States with national reduction targets significantly above the EU average (at least above >33%) and their maximum cost effective reduction potential, plus Malta, should be able to reduce the auctioning volume of their ETS allowances in a specific year. The 2030 council conclusion also indicate that eligible Member States must only be allowed to use a very limited amount of ETS allowances (for example at most 2% of the cumulative deficit of AEAs in 2021-2030) towards the end of the 2021-2030 commitment period.

If it is to be introduced, which Carbon Market Watch opposes, the new flexibility must greatly discourage the use of ETS allowances in achieving the ESD targets to ensure it is only used as a last resort. This can be implemented by applying a discounting factor to disincentive delaying actions in non-ETS sectors. A discounting factor of at least 4:1 must be applied, so that for each AEA generated through the new flexibility, four EUAs need to be cancelled.

Too broad application of this flexibility can lead to the use of up to 300 million ETS allowances, which could increase ESD emissions by up to 15% and EU's overall greenhouse gas emissions by up to 5% in the 2021-2030 period (Oeko-institut, 2015).

#### **LULUCF offsets**

In contrast to the other sectors, the LULUCF sector is a net sink of carbon which means that the sector stores more carbon than it emits. By storing carbon in soils and forests, the LULUCF sector could potentially generate credits in the order of 1.4 billion (or 1,400 Mt CO<sub>2</sub>-eq) in the 2021-2030 period. While it is essential that also the LULUCF sector contributes to greenhouse gas mitigation, several EU countries see LULUCF sink activities as a way to displace efforts in other sectors such as agriculture. However allowing forestry offsets into the ESD could cut the ESD mitigation effort in half and could lead to a 12% increase of EU's greenhouse gas emissions in the 2021-2030 period (see Oeko-institut, 2015: in a scenario where the current LULUCF accounting rules are projected to the 2021-2030 period and the LULUCF sector does not get an ambitious target).

The LULUCF emissions and removals are characterized by potentially large annual fluctuations, while there are uncertainties relating to data reliability. These characteristics make the sector unfit for any flexibility with the ESD that has an annual compliance cycle. Similarly, planting trees in order to displace efforts in sectors where major emissions reductions are needed is risky because the forest sector is a big carbon sink where the permanence of stored carbon cannot be guaranteed.

#### 4. Do you have studies on:

- The implementation of the ESD at the level of Member States and at regional level;
- How the ESD incentivises greenhouse gas reductions in the different sectors concerned;
- Good practices of policies and measures that are of particular interest for sharing with other member states; and
- Other benefits apart from greenhouse gas emission reductions

That you think the Commission should be aware of.

Policy Brief: [Flexibilities in the EU's 2030 Effort Sharing Decision](#)

Report: [Enhanced flexibilities for the EU's 2030 Effort Sharing Decision](#)

Carbon Market Watch [policy briefing](#) on the post-2020 ESD and [report](#) on MS implementation.

In your view, what are the key lessons learned of these studies relevant for the European Commission and other Member States, and what other benefits does ESD implementation bring (e.g. in terms of job creation, energy security, health benefits, ...)?

One of the key lessons of the Oeko-institut study is the importance of early action, not only for the achievement of EU's 2020 climate target, but also for reaching future climate targets. Planned additional measures implemented by Member States up to 2020 will lead to an extra 1,000 Mt CO<sub>2</sub>-eq emission reductions in the 2021-2030 period, easing the attainment of the post-2020 climate targets with limited use of flexibilities. Rather than wasting money on international offsets, Member States should therefore implement additional measures to meet the current ESD targets, which will also enable them to more easily meet future targets.

The reports by Carbon Market Watch highlight that the implementation of the current ESD fails to act as a driver for new EU-wide and national policies. Additional mitigation measures in the ESD sectors would be beneficial not only to the climate but also to EU citizens as they have the potential to create new jobs, increase EU's energy security, lead to cleaner air and higher health benefits and improve access to public transport means. While the 2030 ESD target is relatively more stringent than the 2020 climate target and the use of international offsets will be excluded after 2020, it remains critical that the overall ambition level is not undermined by the introduction of flexibilities with limited environmental integrity. The only way the implementation of the 2030 ESD can fully achieve the before-mentioned co-benefits, is if the overall ambition level of the 2021-2030 period is not undermined by allowing credits from other sectors (like the EU ETS or LULUCF) to offset ESD emissions.

5. Is the current scope of EU-wide action and legislation OTHER than the ESD to support member states' emission reductions in ESD sectors sufficient, or should it be enhanced?

- a) The current scope is sufficient; or  
b) The current scope should be enhanced.

It is of utmost importance to complement the future ESD with EU-wide policies and measures to reduce greenhouse gas emissions in the transport, building, agriculture and waste sector. The ESD will require additional emission reductions of up to 2,500 Mt CO<sub>2</sub>-eq in the 2021-2030 period, compared to the "with existing measures" (WEM) projection scenario (or 1,500 Mt CO<sub>2</sub>-eq compared to the "with additional measures" (WAM) projections). EU-wide mitigation policies for the non-ETS sectors can significantly contribute to these emission reductions, thereby helping Member States meet their climate targets. The Commission should propose an ambitious package of EU measures in the transport, buildings, agriculture and waste sector to accompany the ESD. Many of these initiatives are already planned. Combining these measures into a comprehensive package would not only help Member States meet the 2030 targets, but would also yield significant economic, employment, air quality and energy security benefits.

#### **Transport:**

Transport is currently the biggest ESD sector and EU measures are essential to achieving the 2030 ESD targets. These measures should include:

- Ambitious CO<sub>2</sub> standards for new passenger cars and light duty vehicles, for the year 2025.
- A road package including a review of the EU road charging rules for heavy- and light-duty vehicles aimed at mandating infrastructure charging, phasing out vignettes and enabling CO<sub>2</sub> differentiated charging for light and heavy vehicles.
- A comprehensive strategy on the electrification of surface transport.
- Robust post-2020 rules to reduce the carbon intensity of Europe's transport fuels, taking into account all the GHG emissions of biofuels and the higher carbon intensity of certain fossil fuels, while excluding the use of international offsets.

- A proposal to integrate the emissions from international shipping into the EU's 2030 climate framework.

### **Energy savings in buildings:**

The largest cost-effective ESD reductions potentials lie in the building sector. EU measures that help Member States to increase the energy efficiency of buildings:

- Increase the EU's 2030 energy savings target to 40% and revise existing energy savings policies to help achieve this target.
- Revise the Energy Efficiency Directive to extend the 3% renovation rate to all public buildings and extend the energy efficiency obligation schemes (article 7) beyond 2020 while removing exemptions that reduce its ambition
- Regularly tighten the minimum energy performance standards through the Eco-design Directive implementing measures, thereby pulling the least energy efficient heating and cooling products of the market, while ensuring that labelling requirements are improved so that consumers can make an informed choice.

### **Agriculture:**

EU air quality policies such as the revised National Emissions Ceilings Directive have the potential to reduce non-CO2 agriculture emissions if ambitious national emissions ceilings are set for ammonia and methane. In addition, Member States should draw up and adopt national climate programmes for agriculture for both methane and nitrous oxide emissions reductions. These programmes must for example include livestock feeding strategies, promotion of farming system using crop rotation including nitrogen fixing crops and low-emission manure storage systems + spreading approaches. The receipt of payments under the Common Agricultural Policy should be linked to such ecological requirements and climate protection measures.

### **Waste:**

EU's waste policies must incentivize waste prevention through an ambitious reuse target and a phase-out of incineration as part of the new proposal for the Circular Economy Package. The Impact Assessment of the withdrawn Circular Economy Package shows that an increase of the recycling and reuse targets for waste would deliver reductions of 443 Mt CO2-eq between 2014-2030.

6. Is there a need for additional EU action in terms of capacity building and similar support targeted at the regional and local level to facilitate national policies and measures under the ESD after 2020?

- a) Yes
- b) No

Yes, there is a need for more capacity building and support to increase awareness about the benefits of national policies and measures to reduce emissions in the transport, buildings, agriculture and waste sector after 2020. In addition, the annual guidance to Member States in the European Semester must also give recommendations for policies to phase out environmentally harmful subsidies, such as subsidies for unsustainable agriculture practices or subsidies to company cars that not only negatively impact public budgets but also aggravate environmental problems caused by the agriculture or transport sector.