Carbon Market Watch Reaction to the leaked 2030 Council Conclusions

17 October 2014

The latest leak of the 2030 Council Conclusions (dated 16 October 2014) provides further reason to worry about the future integrity of our 2030 climate target. As explained in our previous reaction from 2 September (see here), due to technical loopholes in the current climate framework, 4 billion tonnes of hot air will accumulate which threatens EU's future climate ambition.

Without immediate and urgent action, to avoid the banking of this hot air, the actual emissions reductions under a 40% target may be as low as 26%[i].

In a nutshell, the latest Member State comments and the leaked document suggests:

1. Reducing domestic greenhouse gas emissions by merely 40% = Postponing much needed climate action until after 2030.
2. Possible banking of hot air = Turning the proposed 40% GHG target into mere 26% reductions!
3. Allowing countries to use EU ETS allowances to meet their climate targets = Jeopardizing mitigation in the non-ETS sectors.
4. Inclusion of transport in the EU ETS = Inventing an alibi to do nothing to reduce transport emissions.
5. Dynamic allocation of free pollution permits = Increasing subsidies to industry instead of having them pay to pollute.

However, the final decision has not yet been taken. Although certain countries are actively advocating for carrying-over the EU's hot air[1], proposals on other flexibilities, such as domestic offsetting might curtail the need for such banking. Transferring emission allowances between Member States (domestic offsetting) would not undermine the overall climate ambition nor the incentives for decarbonisation. Instead, domestic offsetting could unlock the mitigation potential in poorer Member States and could be the reason not to allow for banking, which directly undermines any demand for domestic offsets.

Below is a first reaction to what the latest comments by countries and the leaked draft text would mean for the future EU climate framework:

1) Reducing domestic greenhouse gas emissions by merely 40% = Postponing much needed climate action until after 2030

The leaked Council conclusions read:

2. *The European Council endorsed a binding EU target of a 40% domestic reduction in greenhouse gas emissions by 2030 compared to 1990.*

[1] See: http://www.mos.gov.pl/g2/big/2014_09/d6cdc9370500325c6f02a77f46f9d1c5.pdf

By agreeing to a target of **merely 40% domestic** greenhouse gas emission reductions by 2030 compared to 1990, the EU countries are hence **postponing climate action until after 2030**. Between 1990 and 2030 the EU needs to reduce its emissions by 1% annually, while between the 2030 and 2050 a doubling of this reduction effort is required as emissions need to fall by at least 2% annually. Postponing most of Europe's climate action into the unforeseeable future is a risky strategy that could bring us on a path to dangerous climate change.

Also in light of the international climate agreement in which all countries need to step up their effort to reduce their greenhouse gas emissions, the EU should be in the position to raise its climate ambition.

The leaked 2030 Council Conclusions propose a climate target of merely 40% domestic emission reductions. To avoid that most of the climate action is postponed until the unforeseeable future, Heads of State should instead ensure that the option to move the EU target for domestic emission reductions well beyond 40% is kept open.

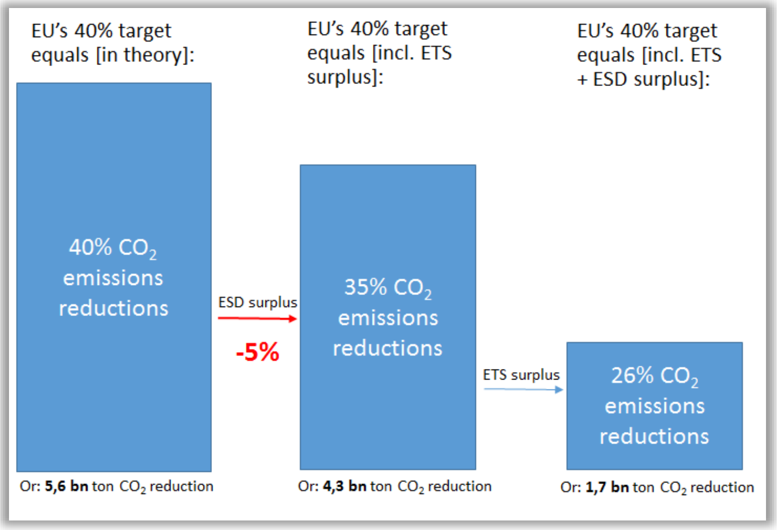
2) Banking "hot air" = Turning the Commission proposal into a 26% GHG target!

<u>The leaked Council conclusions read:</u>

2.10 *<u>The availability and use of existing flexibility instruments within the non-ETS sectors will be significantly enhanced</u> in order to ensure cost-effectiveness of the collective EU effort and convergence of emissions per capita by 2030.*

This paragraph **does not exclude the banking of EU's hot air**, which is a result of the surplus pollution permits generated by the EU's climate targets that were set in 2007 when EU's Heads of States agreed to reduce EU's emissions by 20% in 2020. The EU's hot air is estimated to equal to almost **4 billion emission allowances** and worryingly, certain Member States (including the Visegrad group and Lithuania) are actively advocating for adding a specific reference to the banking of hot air by proposing to add: "including the banking of unused non-ETS allowances after 2020" to the paragraph.

The 4 billion rights to pollute are distributed between the two policy instruments Emissions Trading Scheme (EU ETS)[ii] and the Effort Sharing Decision (ESD)[iii]. While the question of how to address the surplus under the EU ETS (equaling **9%** of the EU's GHG target) is currently under way as part of the Market Stability Reform (MSR) proposal in the European Parliament[iv], the fate of the pollution permits under the ESD (equaling **5%** of the EU's GHG target) are in the hands of Europe's 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[v]. 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[vi].

This means that by 2020 there could be a carbon '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.

The leaked 2030 Council Conclusions do not exclude the option of carrying-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 add a specific reference to disallow the banking of hot air after 2020.

3) Allowing countries to use EU ETS allowances to meet their climate targets = Jeopardizing mitigation in the non-ETS sectors

The leaked Council conclusions read:

2.10 [...] The Commission is invited to put forward concrete proposals that will ensure new flexibility in achieving targets for the most ambitious Member States through limited use of the ETS allowances, while preserving predictability;

This paragraph would allow countries to **use ETS allowances to meet their national (non-ETS) climate targets**, a provision that was advocated for by Denmark and Malta. This is problematic as the EU ETS is currently oversupplied by more than 2 billion emission allowances which sell for a historic low price of around €5. When introducing linkages between the ETS and the non-ETS sectors, there is a risk that the problems with the one instrument will spill-over to the other making both instruments less effective in driving down emissions.

At this moment, the carbon market fails to send a signal for decarbonisation in the power and industry sectors. Allowing cheap ETS allowances to offset emissions in the building and transport sectors could also put the decarbonisation of these sectors at risk. It reduces the incentives to take effective mitigation measures that can lead to better insulated buildings or a more efficient transportation system. In order to fix the problems with the EU ETS, the excess emission allowances need to be permanently removed from the system, instead of having them flood into the non-ETS sectors.

The leaked 2030 Council Conclusions propose to allow countries to use ETS allowances to comply with their non-ETS targets. To avoid that the problems of the EU ETS jeopardize mitigation in the building, transport and agriculture sectors, Heads of State should instead ensure that the reduction efforts of the ETS sectors remain separate from those of the non-ETS sectors.

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

The leaked Council conclusions read:

2.11 […] It also recalls that under existing legislation a Member State can opt to include the transport sector within the framework of the ETS;

This paragraph will further enable countries to include **transport fuels**, currently covered by the Effort Sharing Decision, into the EU ETS. It seems that in particular Denmark is keen to explore this option to avoid putting in place effective policies to reduce its transport emissions. This puts the decarbonisation of the transport sector at risk as the €5 carbon price under the EU ETS will fail to incentivize 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 reducing 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&cars legislation that lower fuel consumption or fuel taxation.

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 EU and member states to put in place effective policies.

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

The leaked Council conclusions read:

2.4 Free allocation will not expire; existing measures will continue after 2020 to prevent the risk of carbon leakage due to climate policy, as long as no comparable efforts are undertaken in other major economies, with the objective of providing appropriate levels of support for sectors at risk of losing international competitiveness, taking into account both direct and indirect carbon costs. In order to maintain international competiveness, the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage. Future allocations will ensure better alignment with changing production levels in different sectors. [..]

Under this paragraph it is proposed to **continue** with the current practice of **subsidizing 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 the allocation of free allowances will take into account not only direct carbon costs, but also indirect costs. The allocation will furthermore be based on actual production with the risk that the total amount of free allowances will not be subject to an overall limit 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[vii].

The leaked 2030 Council Conclusions propose to dynamically allocate free pollution permits to industry after 2020, compensating them also for indirect costs. To avoid subsidizing heavy emitters for their pollution, 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.

Carbon Market Watch

Femke de Jong
Policy Officer, Carbon Market Watch
femke.dejong@carbonmarketwatch.org

---

[i] 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).

[ii] For more information on the EU ETS, see our policy briefing "What's needed to fix the EU's carbon market" here

[iii] For more information on the ESD, see our policy briefing "Tackling 60% of the EU's climate problem" here.

[iv] 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 carbon bubble under the EU ETS, the EU heads of state should agree to permanently retire 2.6 billion surplus ETS allowances.

[v] European Commission (April 2014), Technical Annex to Kyoto Ambition Mechanism Report

[vi] European Environment Agency (2013). Trends and projections in Europe 2013

[vii] For more information on "dynamic allocation", see our carbon leakage rebuttal here