

Sandbag's response to the [European Commission Consultation](#) on the preparation of a legislative proposal on the effort of Member States to reduce their greenhouse gas emissions to meet the European Union's greenhouse gas emission reduction commitment in a 2030 perspective.

### About Sandbag

Sandbag is a UK-based not-for-profit think tank conducting research and campaigning for environmentally effective climate policies.

Our research focus includes the phase-out of old coal in Europe; deep decarbonisation of industry through technologies including Carbon Capture Utilisation & Storage; reform of the EU Emissions Trading Scheme; and increasing ambition in the EU 2020 and 2030 climate & energy packages.

The International Centre for Climate Governance ranks us in the top twenty global climate think tanks, from an assessment of more than 300. For more information visit [www.sandbag.org.uk](http://www.sandbag.org.uk)

## 1. Flexibility mechanisms

**Q1. 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?**

To bring the EU back on to the cost-effective path towards its 2050 climate goals, its economy-wide emissions target for 2030 should be 50% below 1990 levels and a correction should be made for past surpluses in both the ESD and the ETS (see Q4 for evidence base). The flexibilities presented below should reduce costs, enabling the EU to adopt more ambitious carbon budgets.

### 5 YEAR BUDGETS

Experience from the ETS and the ESD has shown that the projections used to determine the size of long-term budgets are likely to be inaccurate. It is also politically difficult to introduce policies to correct for oversupply mid-period. Therefore, instead of planning an ESD budget for a 10-year period after 2020, the EU should commit to drafting budgets on a rolling basis for a sequence of two consecutive 5-year periods. Furthermore, 2 years before any period ends, the EU should begin the process for establishing the budget for a new 5-year period further in the future.

## BANKING AND BORROWING POST-2020

There should be no banking of spare allowances from the first ESD period. Surplus Phase 3 ETS allowances are already dragging Europe significantly off course from the cost-effective trajectory to 2050 (see Q4). Banking of allowances from the first ESD would only exacerbate this serious problem.

If a new framework based on 5-year budgets is introduced from 2021, inter-period banking restrictions can be relaxed by making AEs valid for two consecutive trading periods. Allowances from the period 2021-2025 would be valid for use in the subsequent 2026-2030 period, expiring at the end of 2030. Allowances from 2026-2030 would expire at the end of 2035, etc. This would require the AEs to be clearly identified with a period of origin.

This design encourages early action through inter-temporal flexibility but balances this with an automatic ratchet that protects against any over-allocation caused by inaccurate projections.

We also recommend that a parallel framework of 5-year rolling budgets and 2-period validity for carbon allowances should be introduced to the ETS. Any allowances transferred between the ETS and the ESD should keep the same period of origin and expiry date.

Because ESD budgets are becoming progressively tighter, flexibility around borrowing rules should remain the same.

## EMISSIONS TRADING

A completely domestic EU climate target implies greater environmental integrity, but also raises compliance costs. To compensate, MSs should retain complete freedom to sell their surplus AEs. Furthermore, MS compliance should be made easier by creating a carbon crediting mechanism based on domestic projects in ESD sectors. (See Q6 for details.) In addition to these flexibilities, Europe should investigate avenues for using robust credits from international projects if this enables it to step up ambition from a 40% domestic target.

## COMMUNITY OFFSETTING

There may be some cases where MSs – especially less prosperous ones – do not have the capacity and know-how to unlock the cost-effective mitigation available within their borders. To compensate for this barrier towards cost-effective mitigation, the private sector should be allowed to develop projects reducing emissions from activities under the ESD in a manner mirroring practice under Track II of the Joint Implementation (JI) mechanisms in the Kyoto Protocol. Just as under JI, AEs freed up through the implementation of these projects would be converted into credits that could be sold on to MSs for compliance purposes under the ESD.

We provide more detail on how offsetting should be administered under Question 6

***Q. With respect to the latter (AEA transfers among Member States), 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?***

#### **TRANSPARENT PUBLIC PLATFORM**

Bilateral AEA transfers should be discontinued and replaced through trades on a transparent public platform. Project credits should be traded on the same platform. All information about transfers of both allowances and credits (source, destination, volumes, project developers, project types, etc.) should be made available on a yearly basis through a unified public registry.

#### **AUCTIONS**

Auctioning all AEAs through a central platform might be considered, since it could rapidly introduce carbon pricing to the ESD, making national treasuries aware of the need to uncover low-cost mitigation options. However, this would also involve committing treasuries to paying significant sums of money to themselves for assets that, under the currently policy settings, they would be receiving for free – with some redistributive flows between countries with looser targets and those with tighter ones. Instead of such a complex and potentially contentious mechanism, it may be sufficient if price discovery occurred only through MS trade in spare AEAs, with credits generated from ESD abatement projects playing a supportive role.

Another potential route for MSs to introduce carbon pricing and auctioning into current non-traded sectors is to unilaterally include them into the scope of the ETS under Article 24 of the ETS Directive.

## 2. Monitoring, reporting and compliance

**Q2. 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 (explain your reasons);*
- b) Annual reporting with biennial compliance checks with existing corrective action (explain your reasons);*
- c) Biennial reporting with biennial compliance checks and enhanced corrective action (explain your reasons and possible additional corrective actions); or*
- d) Other (with explanation).**

Firstly, we support an annual reporting and compliance cycle in keeping with current practice and in line with the EU's obligations under the UNFCCC. Biennial compliance checks would implicitly enlarge the scope for borrowing, which can serve to delay early action. Moreover, in terms of policy transparency, biennial compliance would constitute a worsening of the current regime, and should therefore be avoided.

Secondly, we would encourage Member States to produce an annual report on how they plan to meet their ESD obligations irrespective of whether they are compliant or non-compliant with the ESD. This would help inform the annual reporting on progress towards EU targets performed by DG Climate Action and the European Environment Agency.

Thirdly, we recommend altering the penalty for ESD non-compliance to make it more consistent with the EU ETS. Under the current regime, Member States that have failed to surrender sufficient allowances to cover their emissions by the compliance deadline are obliged to submit a report on how they plan to get back under budget, and are also required to pay a penalty rate of 1.08 AEs per tonne of CO<sub>2</sub>e for any non-compliant emissions. This regime partly resembles the Kyoto Protocol, which has proved ineffective in curbing the emissions of several notable parties. In place of this system, we propose that a €100 fine should be imposed on Member States for each tonne of non-compliant emissions. Any monies so levied could contribute toward the modernisation fund in the EU ETS, or for other forms of domestic or international climate finance. In addition the Member State would still be obliged to purchase AEs to surrender against its outstanding emissions.

### 3. Setting national targets for GHG emissions not covered by the EU Emissions Trading System

**Q3. 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?**

#### IMPROVED BURDEN SHARING ARRANGEMENTS

Europe's current burden-sharing arrangements are inconsistent and should be better aligned. While the ex-ante cost-effective split between the traded and non-traded sectors should be maintained, we recommend lawmakers adopt a single economy-wide burden-sharing system for distributing allowances to governments under both the EU ETS (EUA auctions) and the ESD (AEAs). Harmonised free allocation to ETS manufacturers should be determined separately.

ETS auctions are primarily distributed using a "grandfathering" approach that rewards the largest emitters. This is supplemented by special compensations to MSs with lower relative income (solidarity) or significant emissions reductions pre-2005 (early effort). The ESD applies yet another system based on GDP/capita. The October Council Conclusions propose to complicate this situation further by introducing a new burden-sharing metric to the ESD in the form of cost-effective mitigation potential. Proliferating metrics is a step in the wrong direction. Burden-sharing rules should be streamlined.

When preparing a single, community-wide burden sharing system, we recommend that an "equity"-based approach should be performed to determine legal responsibility under the national carbon budgets (e.g. based on historical responsibility since 1990). As a general principle it is dangerous to confuse responsibility with cost-effective domestic abatement potential. Applied consistently, this would put inappropriately strict obligations on less developed economies. A more coherent approach to unlocking cost-effective mitigation is to enhance the flexibilities in trading carbon allowances. This will automatically trigger financial flows between richer countries with more stringent targets and poorer countries with less stringent targets.

A more consistent burden-sharing approach across the ETS and ESD would also facilitate the exchange of carbon allowances between the traded and non-traded sectors, because the distribution of government allowances would be the same in each.

#### COST-EFFECTIVE SPLIT

Any ex-ante calculation of the cost-effective split between the ETS and ESD budgets is bound to be imperfect. Moreover, the cost-effective split provided by the Commission (-43%/-30% vs 2005) appears to rely on outdated calculations in the 2050 Low Carbon Roadmap that do not adequately take into account recent ETS emissions and surpluses. Allowing some flexibilities between the traded and non-traded sector budgets will help create a reasonable margin for error.

#### UPDATING ESD BASELINES

The 2030 target for each country is not the sole factor determining its level of ambition. This is also determined by the baseline used for establishing its budget trajectory to reach 2030. The first ESD uses a 2009 emissions baseline to determine the national allocation trajectory over 2013-2020. When setting budgets to 2030 we recommend that this be updated. The new baseline should be the lower value of: a) the 2020 target and b) 2017 emissions baseline (calculated as the average of 2016-18 ESD emissions).

To avoid structuring in unnecessary carbon space, we recommend that the reference point used for determining the trajectory each country takes to its 2030 target should be updated. That reference point should be the lower value of a) the national 2020 target and b) a 2017 emissions baseline (calculated as the average of 2016-18 ESD emissions).

We also urge the Commission to publish an official value for the 2005 baseline that will be initially used to determine the 2030 targets both for the ETS and for individual countries under the ESD.

#### USING EUAS IN ESD

While we support in principle the ability to transfer a limited volume of allowances from the ETS into the ESD, the Council proposal appears to be an ad hoc political compromise. We worry that using large volumes of EUAs for ESD compliance would lead to price volatility in the ETS. The Commission should develop a more detailed and considered proposal.

## 4. Further evidence and studies on implementation of the Effort Sharing Decision at Member-State level and at regional level

**Q4. 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?*

*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, ...)?*

### STUDIES

The following studies support our position that Europe should correct for past surpluses and adopt a 50% reduction in emissions relative to 1990 as its economy-wide target:

1. Analysis from Sandbag shows that 2.6 billion allowances need to be removed from the ETS to get back on the cost-effective trajectory in the Commission's Low Carbon Roadmap against the proposed 2.2% LRF for Phase IV (p.75-6 [https://sandbag.org.uk/site\\_media/pdfs/reports/Sandbag-ETS2014-SlayingTheDragon.pdf](https://sandbag.org.uk/site_media/pdfs/reports/Sandbag-ETS2014-SlayingTheDragon.pdf))
2. Independent analysis from the Potsdam Institute suggests a -28% target in 2020 and a -47% in 2030 are more cost-effective milestones towards Europe's 2050 goal than the milestones in the Low Carbon Roadmap (p.26, [https://www.pik-potsdam.de/members/knopf/publications/Knopf\\_EMF28\\_overview\\_final.pdf](https://www.pik-potsdam.de/members/knopf/publications/Knopf_EMF28_overview_final.pdf)).
3. A review of effort sharing systems performed by Ecofys suggests that -50% target by 2030 is a more equitable contribution from Europe towards a global deal consistent with avoiding 2 degrees of global warming compared with pre-industrial levels (<http://www.ecofys.com/en/blog/what-is-a-fair-contribution-of-the-eu-to-the-2c-limit>).

### GOOD PRACTICE IN ESD POLICY MAKING

The ESD is a substantial second pillar of European climate policy, covering a volume of emissions larger than the ETS. We call for a tightening of the ESD budgets, supported by greater use of market based mechanisms to assist with compliance. Meeting a tighter ESD budget can be made cost-effective by adopting the flexibility mechanisms outlined under Question 1. Because of the current surplus in the ETS it is important that the two pillars should not be linked too closely, too early, unless ambition is increased beyond the targets in the Council Conclusions of October 2014.

## 5. Complementary EU-wide action in the sectors covered by the Effort Sharing Decision

**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.**

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.

Policies that create a cap on overall emissions can be an important supplement to more targeted policies to achieve specific outcomes (e.g. carbon emissions standards on vehicles). Cap and trade policies can exist alongside supplementary policies which can be justified on the grounds of both longer term carbon abatement options (buying down the cost of technologies) and non-carbon grounds (e.g. air quality, energy security, balance of trade).

### LULUCF

A number of reasons speak against expanding the scope of the ESD pillar to include the current LULUCF pillar. First, seasonal trends can make LULUCF emissions unpredictable, making it difficult to assess the impact of policy. Because of this, carbon data on forest inventories is gathered over long periods of around 5-10 years, making it even more difficult to assess compliance and adapt policy accordingly. Furthermore, the data gathered is often tainted by high degrees of uncertainty – creating room for phantom emissions/cuts.

Rather than allow these factors to affect the transparency and effectiveness of the ESD pillar as it currently stands, LULUCF should be kept separate. Concerns about data reliability also speak against allowing credits generated through LULUCF projects from entering other pillars.



## 6. Capacity building and other support to implementation at national, regional and local level

**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**

As indicated in Q1A, we feel that Community offset projects in the non-traded sector represent a key avenue for capacity building in less prosperous Member States with lots of cost-effective mitigation potential. The credits generated from these projects should be eligible towards national compliance under the ESD.

Not only would this trigger financial flows between richer countries with more stringent targets and poorer ones with less stringent budgets, but it will also provide a more immediate incentive to develop governance structures in poorer countries. Such economic activity will lead in these countries to the birth of domestic policy communities around the climate agenda with a positive and constructive mind-set, enabling a more climate-aware policy dialogue on the EU level in the future.

To facilitate the spread of such projects into countries with weaker governance frameworks, it is necessary to introduce measures that make this mechanism attractive. Because most of these governments will be facing a tough ESD budget for the first time, credits generated from projects should be split between the private project developers and the host governments, thereby making compliance relatively less expensive to these MSs.

Nevertheless, promoting the diffusion of such projects throughout Europe should not come at the cost of environmental integrity. In order to ensure that crediting reflects real emission cuts, consistent accreditation methodologies, enforced through independent third party verification, must be implemented throughout the EU. The Commission must also set up a credit registry tracking their accreditation, sale, and surrender. Credits should ideally be commercialised through the same platform that MSs would use to sell off spare AEs.

### CONSULTATION DESIGN

Finally, Sandbag has a number of misgivings about the format and design of this online consultation. The small number of questions, and the restrictive character limit for some of the more involved or bundled questions have made offering structured suggestions about how to improve this complex policy difficult.

More open ended questions about the nature of the burden share between the ETS and non ETS and between individual countries would have been welcome, as would have questions on the appropriate overall targets and budgets for the ESD. In particular, an “other matters” question would help respondents raise issues that had not been anticipated by the Commission.

Finally, imposing a text-only digital format makes it impossible to insert tables or charts, which can be a much more efficient way of communicating information, especially numerical information.

## About this consultation response

Full information on Sandbag and our funding is available on our website ([www.sandbag.org.uk](http://www.sandbag.org.uk)).

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