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## CEPS Submission to European Commission public consultation on the Effort Sharing Decision in a 2030 perspective

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### Flexibility Mechanisms

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?

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?

*Use of flexibility mechanisms should not be an end in itself, it should only be allowed in order to enhance the cost-effectiveness of the EU, without impacting market functioning and predictability or maintaining the environmental integrity of the targets (i.e. meeting the targets at the end of the period)*

*Having a visible price signal is very important as it provides transparency and sense of comparability with EU ETS abatement efforts. Enhancing existing features and introducing new ones can achieve more transparency in non-ETS sectors.*

*Trading of AEAs is currently possible but rarely used. There are many reasons for this, starting with the lack of need, as meeting targets has not been difficult as well as the lack of clarity whether AEAs can be traded or even defined as a unit. The lack of trading platforms and mechanisms such as auctioning have also contributed to the near absence of any price discovery for abatement activity in the non-ETS sectors.*

*Finally, the fact that there is no project mechanism available to the non-ETS sector has not helped, considering that Article 24a (which could generate credits or allowances to be used in ETS or ESD) has not been operationalized. It is also clear that there could be a great benefit if an independent ESD project mechanism could be created and used for meeting targets under the ESD.*

*Increased flexibility will be very useful as it would lead to more efficiency, increased solidarity, new business opportunities and therefore smoothing the transition to a low-carbon economy.*

*Other ways could be imagined to increase flexibility, but they need to be considered carefully in view of their potential side effects. One is the use of increased banking and borrowing, which is possible under current provisions.*

*Carry over between phases is not possible in the current legal framework. Introducing it can be seen as harming the integrity of the 40% target and compromise mitigation incentives.*

*A parallel could be drawn with the EU ETS where oversupply and carry over has led to a large overhang of allowances and a delay in mitigation action. In addition, mechanisms have been introduced in the ETS (such as the MSR) to address these side effects which are not available in the ESD, and probably not applicable.*

*Raising thresholds beyond the current level of 5% is also an option. This needs to be seen as going to the direction of meeting the EUCO Conclusions that refer to “significantly enhanced”. This is a very tempting approach, but caution is warranted as it could lead to inefficient carbon lock-in as well as a risk to the environmental integrity of the ESD targets if high levels of borrowing takes place leading to non-compliance in the later years of the period.*

*Including further flexibility e.g. via using credits from LULUCF would compromise the integrity of the target, as it is based on the IA calculating the pathway in the ETS and current ESD sectors. Furthermore opening the ESD – but not the ETS – for LULUCF credits would put the respective caps (minus 43% and minus 30% vs 2005) in question, as both were calculated without calculating the inclusion of LULUCF credits. Opening this question seems highly inadvisable.*

## **Monitoring, reporting and compliance**

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

*We feel that an **option D, Other**, which we define as: “annual reporting and annual compliance checks with enhanced corrective action” would provide the best solution for monitoring, reporting, and compliance post 2020.*

*There are various reasons why it is sensible to provide for annual checks and reporting obligations which include:*

- *In the post 2020 period the stringency of targets will increase, resulting in an increased probability of non-compliance and compromise the cost-efficiency and integrity of the overall EU climate targets*
- *Policy monitoring: while reaching the current targets does not require much policy innovation from MS, this may be different with more stringent targets – hence, it is important to follow the progress made by MS. In relation to this, the data and information gathered should give a better indication on whether it is necessary for the EU to propose or adapt some of the harmonized EU measures which cover the non-ETS sectors.*
- *The facilitation of new or enhanced flexibility mechanisms, especially where project mechanisms and trading platforms are involved, requires close monitoring.*

*In addition, corrective action mechanisms that are stricter and which include pecuniary measures, in line with those found in ETS Directive for operators. Any income from pecuniary measures should be used for innovation funds of EU ETS.*

## **Setting national targets for GHG emissions (non-ETS)**

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?

*The EU, in designing the mechanisms and programmes for reaching its targets, both in the EU ETS and non-ETS sectors, needs to balance cost-effectiveness with fairness and equity to the circumstances of different Member States. The issue of solidarity is an important principle in the EU.*

*GDP per capita and the expected cost of abatement are important elements in determining how this equity can be best achieved. Two important approaches come to mind. A first one relates to auctioning which is currently part of the ESD Directive where it is currently only mentioned in the recitals as “Such transfers [of AEAs] may be carried out [...] including by means of auctioning [...]”.*

*Auctioning is an inherently efficient mechanism that would play an important role in price discovery and also give the opportunity for Member States to receive funds from the auction. At the same time, it would provide Member States that have high GDP and high abatement costs to use the predictable flexibility of auctions to access AEAs.*

*Auctioning could take many forms. In this case what can be envisaged is a X-percent auction of AEAs for all Member States. The proceeds of this auction could be distributed back to Member States according to the same distribution key as the AEA origin.*

*Such an auction could play two roles. One role would be that of a flexibility mechanism allowing access to AEs. The second one may be more distributional with potential impact on the yearly required effort. The higher the percentage, the more this is becoming a distributional tool.*

*One additional issue would be whether participation would be voluntary or compulsory. As voluntary auctioning is already possible, but not happening, it seems that obligatory participation would be more effective and would harmonise practices in the ESD. Voluntariness in auctioning would be in line with the principles of proportionality and subsidiarity.*

*The second approach is the proposed one-time reduction through a limited amount of ETS allowances which is referred to in the October EUCO Conclusions. This is an interesting idea but one that requires careful consideration. A number of issues come to mind. First is the impact and uncertainty for operators in the EU ETS. Any transfer of EUAs would have to come from the auctioning schedule, which ensures that the hedging needs of the power sector are met.*

*Such a transfer would result in lower liquidity and potentially impact market functioning as well as increase electricity prices. In addition, higher EUA price levels would also negatively impact industrial sectors under the ETS.*

*Another important impact would be the transfer of current large surpluses into the ESD. It must be remembered that significant effort has been put into establishing the MSR under the ETS to address surpluses but that such mechanisms do not exist in the ESD. This could lead to a compromise of the environmental targets of the ESD.*

*This is of course all a function of how such transfers are put into effect. The October EUCO Conclusions refer to a "limited one-off reductions of allowances to be decided before 2020". As this is a very contentious issue among stakeholders at this time, further constraints could be envisaged. One such example could be that such transfers could only take place towards the end of a compliance period and/or only for Member States that have a GDP per capita significantly above the EU average as a last-resort option.*

*Finally, if a Member State wishes to make use of such a mechanism it should be announced at the beginning of a phase, so as to ensure predictability.*

## **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.***

*The issue is what is the scope of EU-wide policies. A number of measures could be imagined that can be implemented. However, the timeframe of the implementation and the surrounding conditions would play an important element in determining whether such actions are wanted or not.*

*One issue would be the inclusion of fuel distributors in the EU ETS. This is an approach that is currently being put in place in the California ETS. However, such an approach requires preparation and a good time horizon, which may or may not apply in the context of this discussion. Currently fuel is associated with transportation and the approach for mitigation in that sector.*

*The road transport sector is highly regulated through performance standards which are proving to be effective. Putting the transportation sector in the ETS at this time while the ETS is still in a period of transition to more representative long-term prices may not be the most effective way to regulate the sector.*

*The issue of double regulation would promptly emerge with the ETS in its current manifestation not being the best tool. This could lead to the temptation to remove current pieces of legislation which have proven to be effective. It would certainly create upward pressure on prices without having meaningful impact on changes on car technology and reductions of emissions.*

*The elasticity of the car industry to fuel prices is very low and would require socially unacceptable carbon prices before consumers change purchasing behaviour. As such this is a valid idea, but significant amount of preparation needs to be taken before implementing such a measure.*

*A second idea approach would be the use of international credits for compliance in the non-ETS sectors in conjunction with the EU ETS. This, however, can only be seen in the context of a more ambitious target than the 40% currently envisaged. Raising the target and including international certificates beyond the minimum target would help the EU to continue to be a player in the global carbon market and enhance global action via carbon markets / carbon pricing.*

## **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***

*No – the current institutions have not been put to the test properly yet, given the relative ease of meeting 2020 targets. Before considering additional measures, the current system should be given a chance in an environment with more ambitious targets. This would also be in line with subsidiarity and proportionality, principles which seem to clearly inform non ETS/ESD.*