

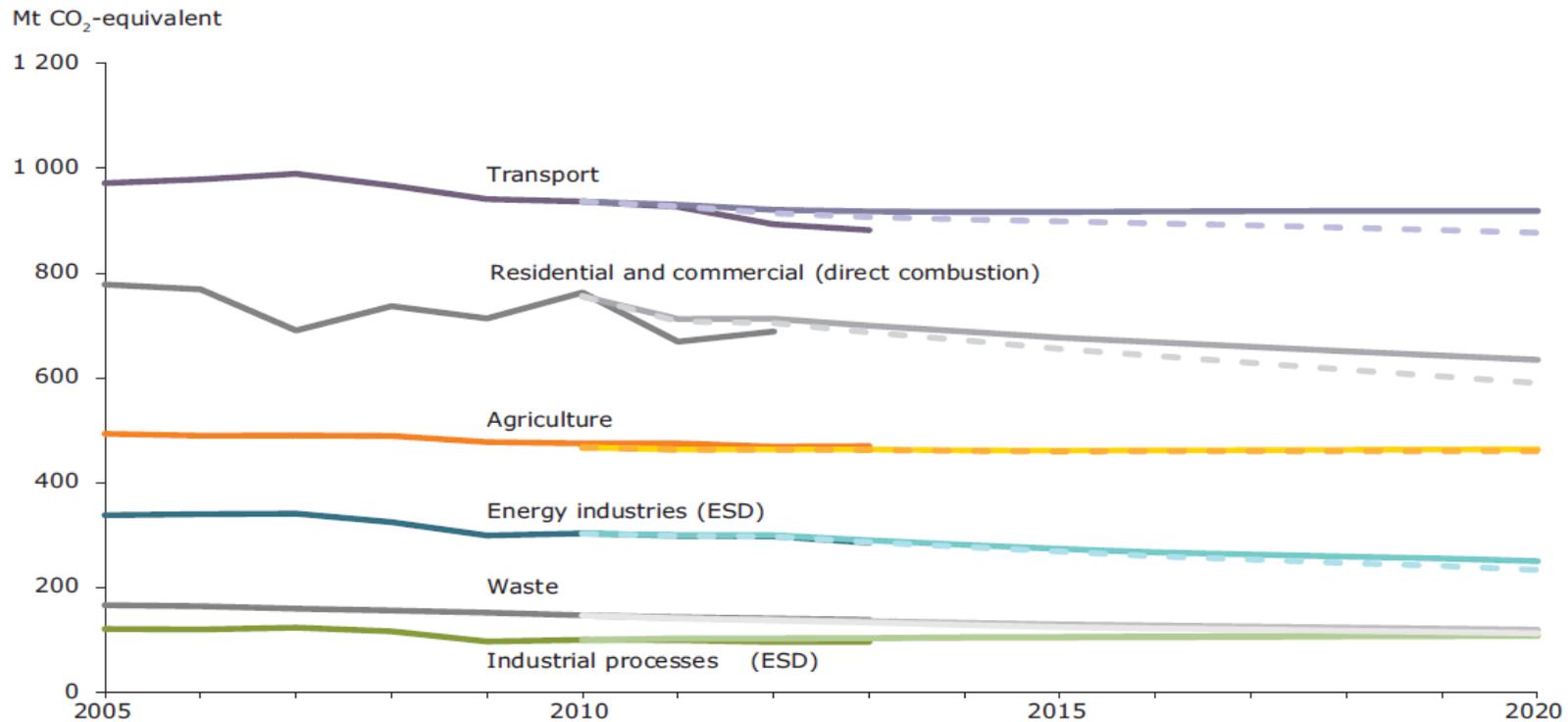
Reducing emissions in non-ETS sectors in the EU2030 Climate and Energy Framework: Issues and Options

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Outline of presentation

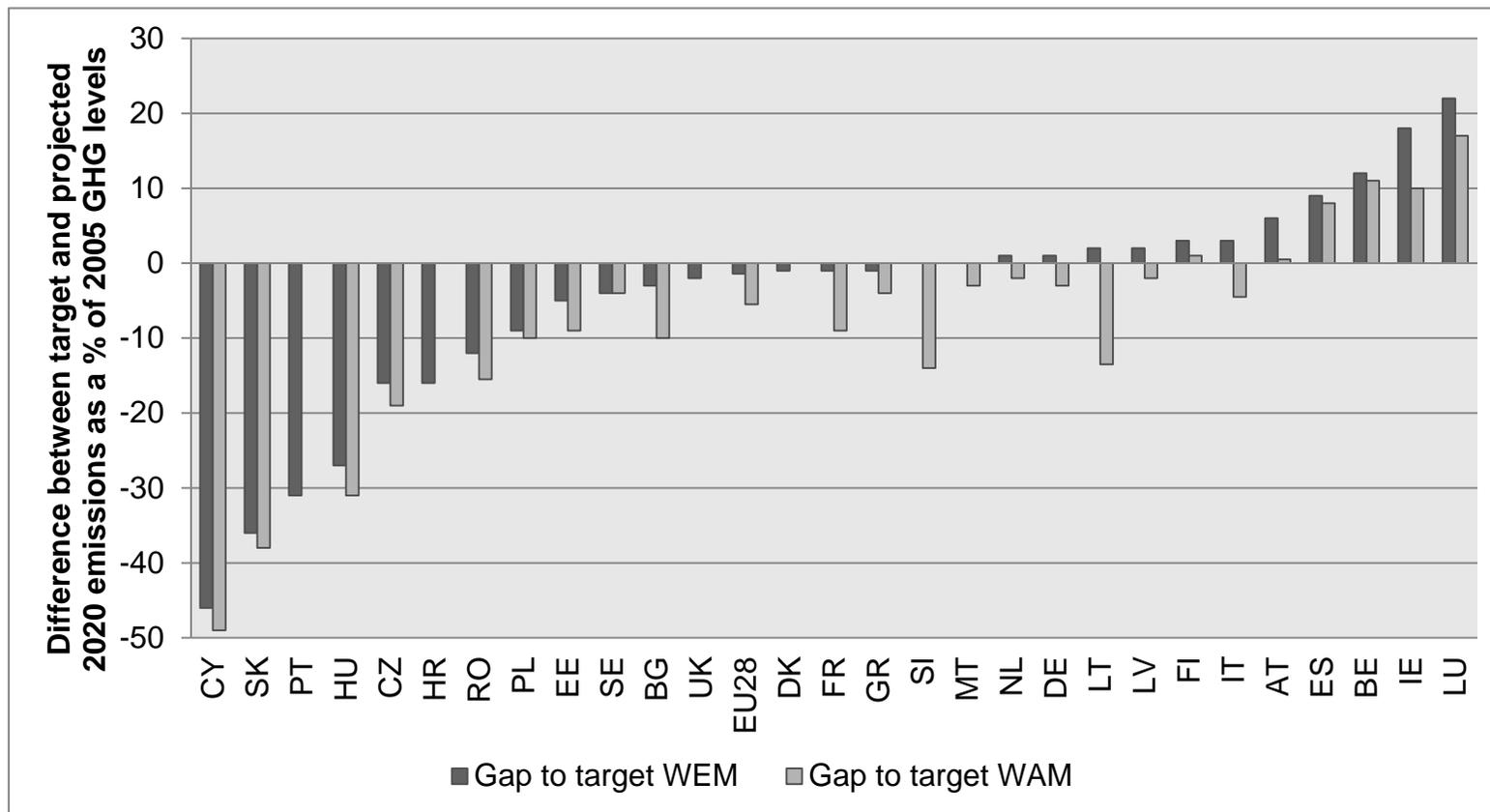
1. Quick Context:
 - Emissions non-ETS sectors &
 - The October Council conclusions
2. Some new implications for EU & national policy
3. Exploring options for effective implementation:
 - Implementing « Enhanced flexibility »
 - Increasing effectiveness of EU funds for projects in non-ETS sectors

1. Context: EU Emissions from Non-ETS sectors



- Non-ETS sectors represent 60% of EU GHG emissions (ex. LULUCF).
- EU on track to reduce by 11-15% vs 2005 in 2020 depending on scenario; vs 2020 target of 10%.
- 2030 Baseline under EC reference scenario is -20% in 2030.

1. Context: Member State progress in Non-ETS sectors



- Progress by MS varies significantly and does not necc. reflect policy effort.
- Potential surplus of AEAs by 2020 is 700-1200Mt CO₂eq.

Context: the October Council conclusions

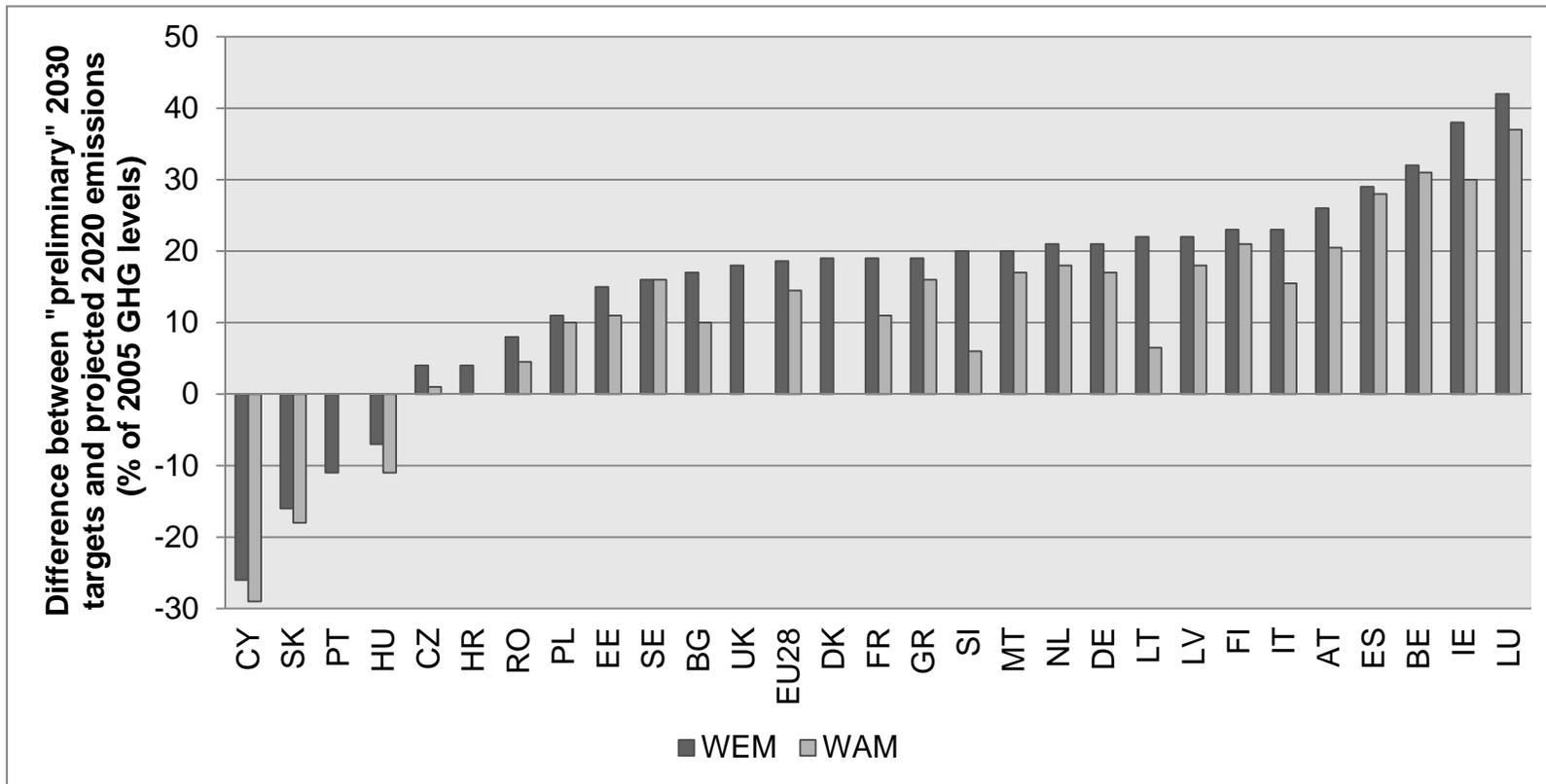
Guiding principles:

- Reduce emissions -30% vs. 2005 levels
- MS targets between -40% and 0% based on existing formula, but..
- Affirmed principles of « fairness », « cost efficiency », and long run decarbonisation and « convergence »
- Noted the importance of « enhanced flexibility », « enhancing access to finance of small and medium scale projects ».

Technical aspects

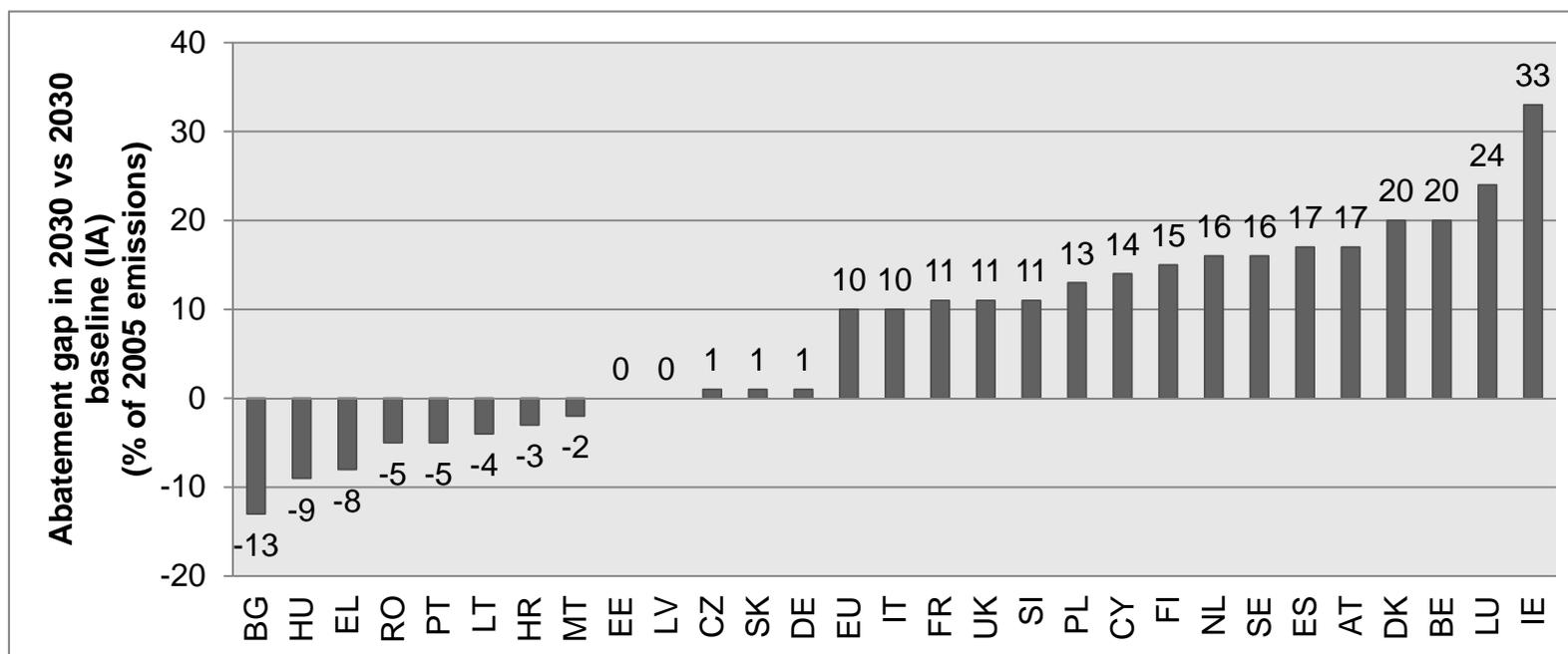
- Inclusion of LULUCF
- Directed Commission to explore options for transport sector post-2020.
- Established a reserve of 2% of ETS auction revenues for MS with high investment needs for EE and modernisation of «energy systems »
- Unspecified adjustments to reflect cost effective potentials of rich MS.

2. Some Implications of Council Conclusions



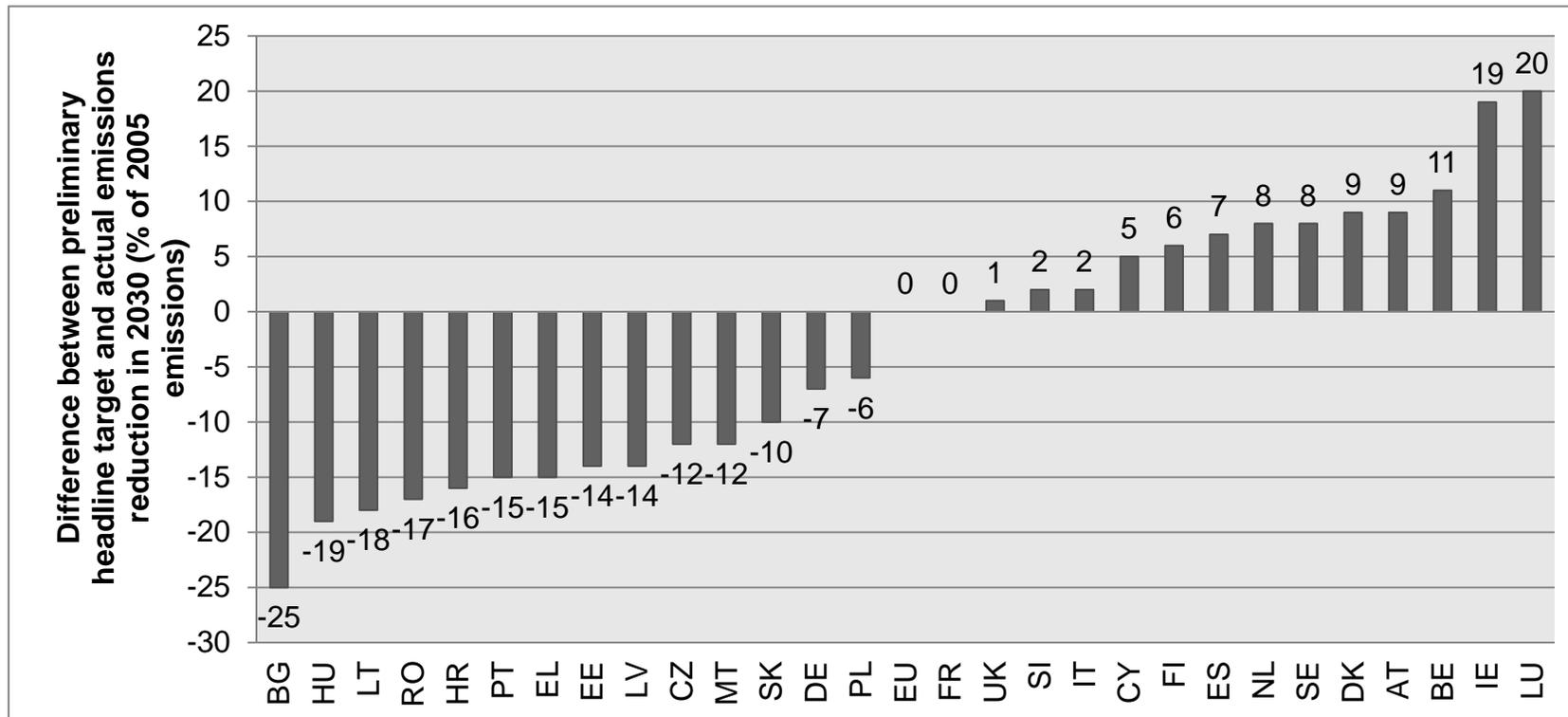
Prima facie, MS will need need to make significant additional reductions vs 2020 levels (vs. existing and planned policies as of late 2013.)

2. Some Implications of Council Conclusions



- Size of additional effort depends critically on assumptions about baseline emissions (among other factors).
- Key issue is implementation of new policy, such e.g. EED. However, evidence of low policy engagement with ESD2020/EED...
- *Ceteris paribus*, a strong role for additional efforts to implement existing policies, new policies + flexibility

2. Some Implications of Council Conclusions



- The role of flexibility mechanisms and policies in CEE MS is greater if one assumes pursuit of cost-effective outcome. (70-100MtCO₂e of trade in 2030)
- Difference in these two scenarios also shows potential to go much further in 2030 in CEE Member States

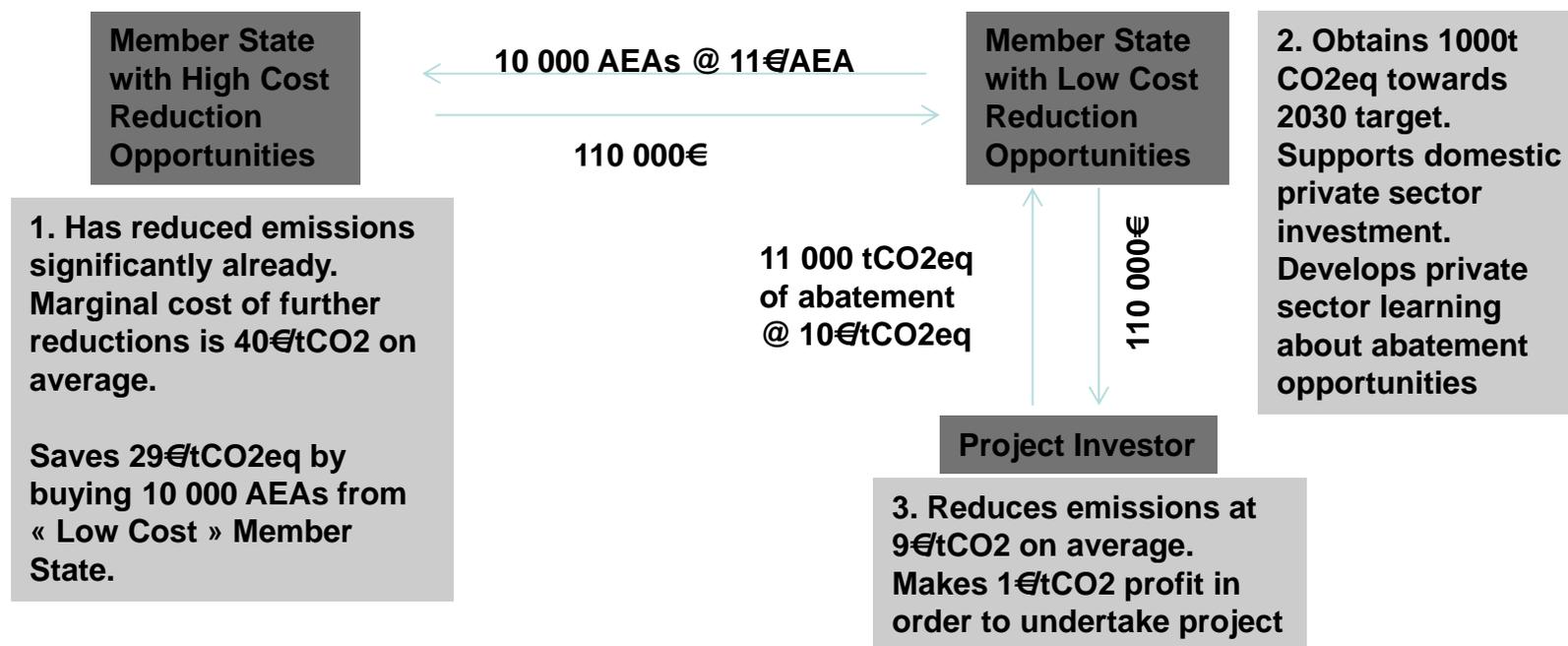
3. Some implications for implementing 2030 Framework

1. A priori, a **strong role for additional policies/greater implementation efforts** (national and EU)
2. Active (rather than passive) use **flexibility likely to be more important in 2030 than in 2020, even allowing for explicit new mechanisms.**
3. Important to **incentivise CEE Member States in going beyond their headline targets.**
 - Improve cost effectiveness
 - Increase current levels of public/private sector engagement and build capacity to pursue deeper emissions reductions in future.
 - Promote effective use of EU Cohesion and related funds for climate related projects
4. Some important **uncertainties still remain** :
 - Carry over of allowances from ESD2020 (potentially 1.2GtCO₂e of AEAs vs. ~0.95Gt of required additional abatement!!)
 - Rules around LULUCF, ETS transfer.

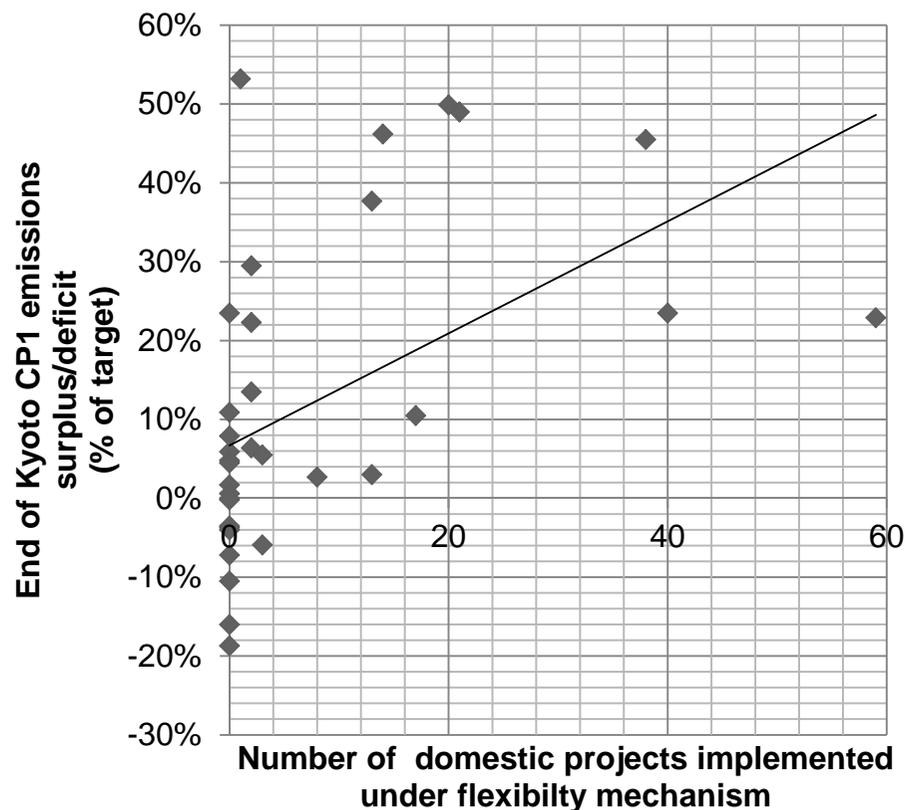
4. Implementing enhanced flexibility

- In principle*, Member State trading is an attractive option to ensure adequate flexibility, enhance cost effectiveness and promote learning and capacity building in CEE MS....

The classical model



4. Implementing enhanced flexibility

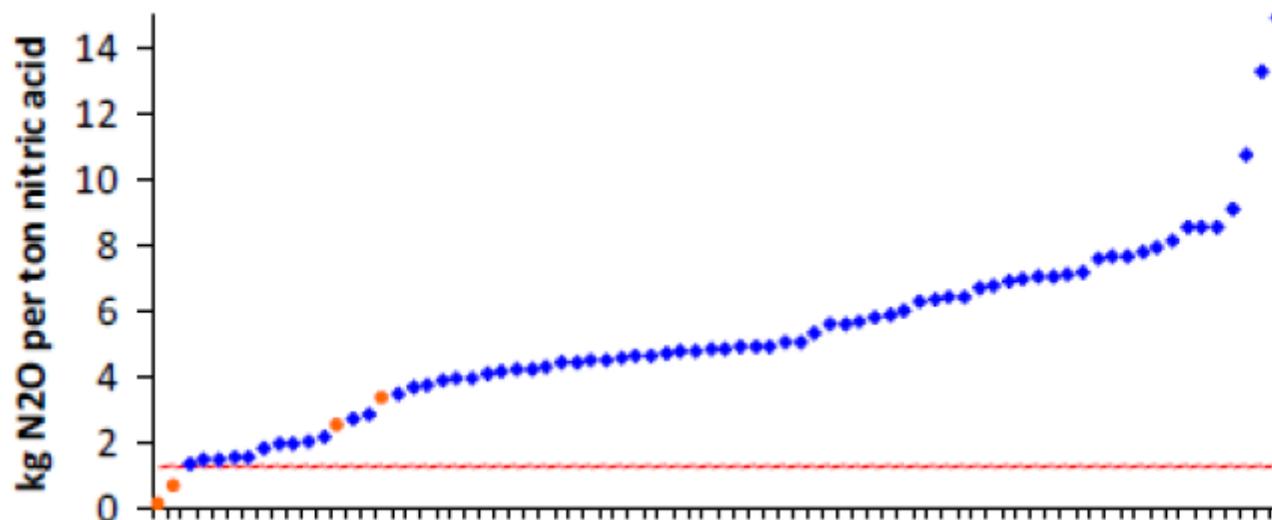


However, *in practice*, past experience has shown important weaknesses with MS-MS trading as designed in previous schemes:

1. MS reticent to host projects unless they are they are « long », (cf. graph) (JI)
2. Stakeholder concerns about MS purchasing « hot air » projects (JI)
3. Buyer MS concerned about impact on domestic investor certainty (EU RES Directive)
4. Risk of creating market bubbles + hurting investor certainty (CDM/JI)
5. Managing MRV and admin costs (CDM/JI)

4. Implementing enhanced flexibility

Figure 9 – Benchmarking of N₂O emissions of nitric acid plants in EU27

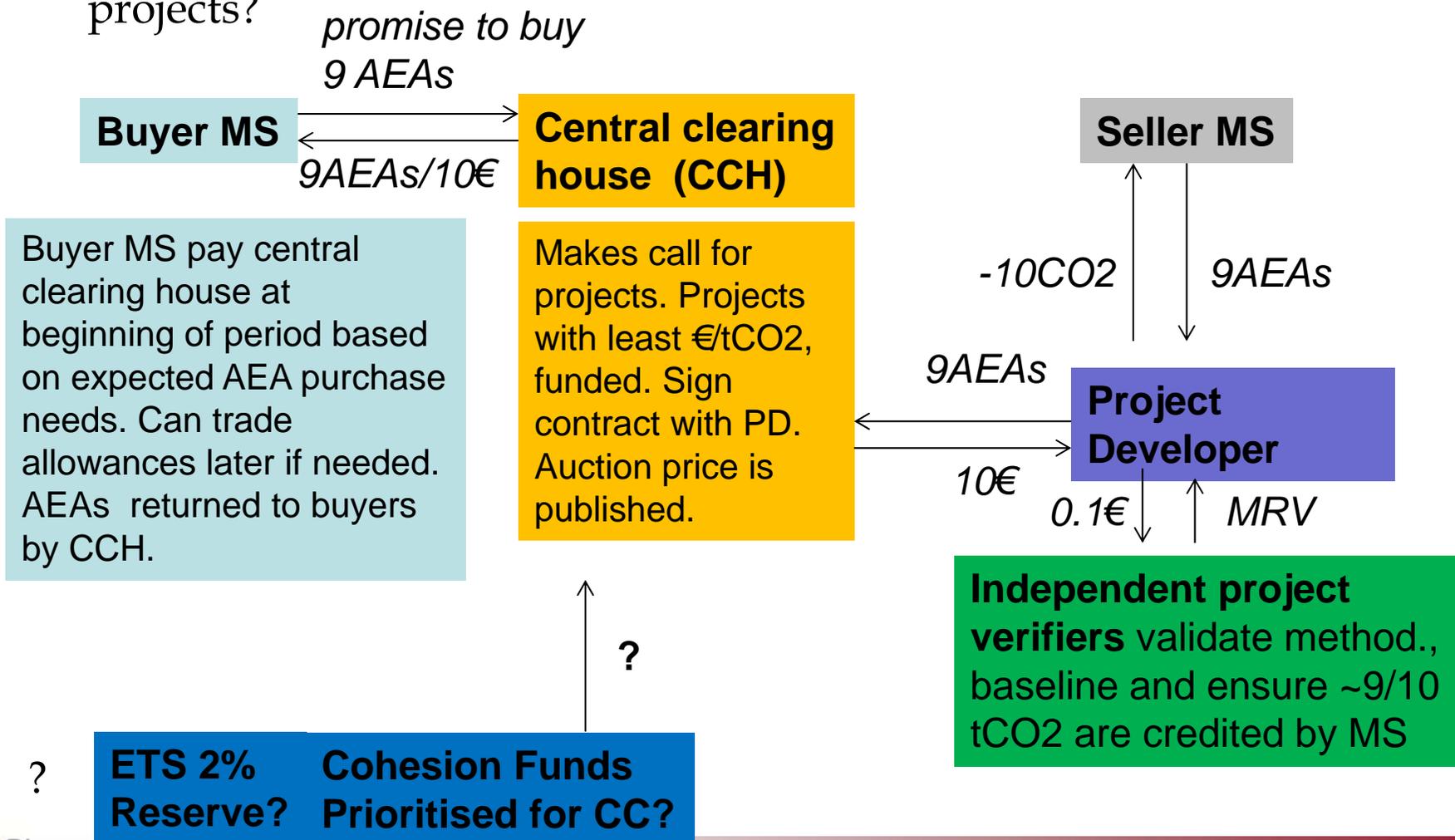


Source: Ecofys, 2009

- However, the potential value of allowing private sector to capture carbon value from the projects was also demonstrated.
 - E.g. N₂O emitters under JI projects saw BAT fall from 1.3kg N₂O/HNO₃ to 0.3 kg N₂O/HNO₃. This is now reflected in lower ETS benchmarks.
 - E.g. Numerous examples of innovative projects that go beyond minimum requirements of regulation (OECD, 2011)

4. Implementing enhanced flexibility

- So why not improve such a system with a central clearing house for projects?



4. Policy options: enhanced flexibility

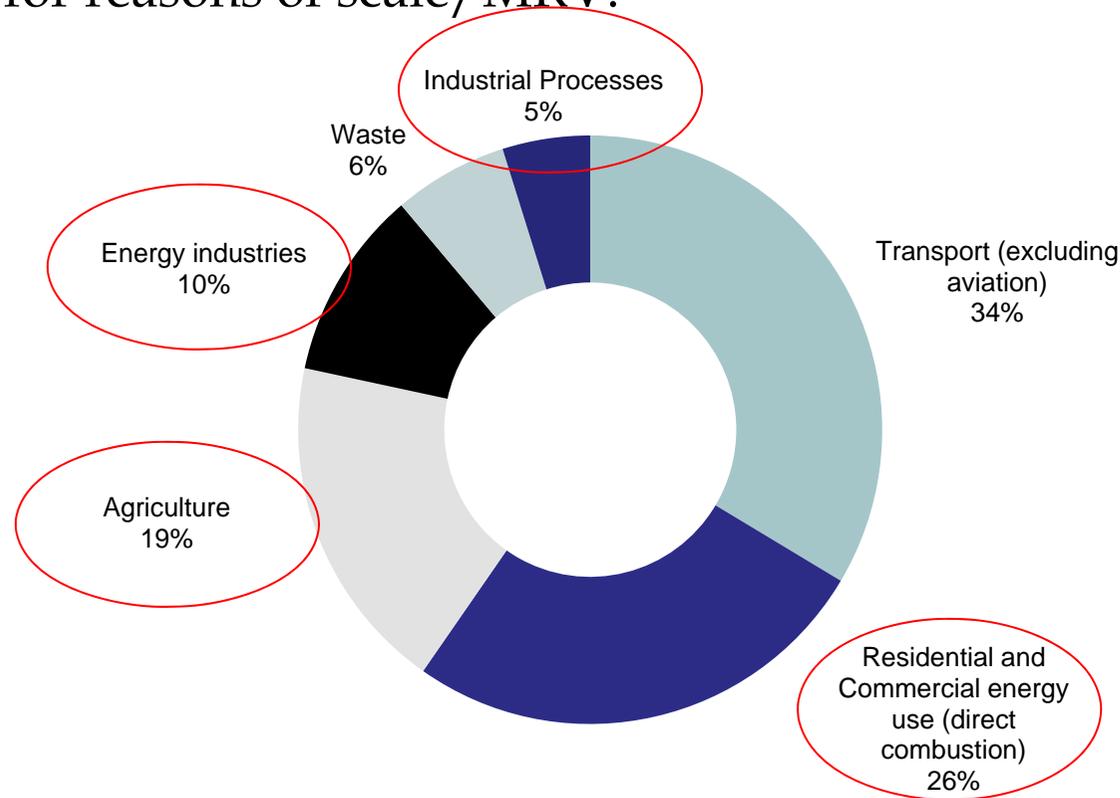
Problems with past flexibility mechanisms	Solution provided by Central Clearing House
1. MS reticent to host projects unless they are « long »	Safeguards embedded in harmonised project crediting principles for whole EU. Creates pool of funds hosts want to access.
2. « Hot air »	Centralised approval process ensures funds only allocated to real projects.
3. Buyer MS concerned about impact on domestic investor certainty	Greater predictability via enhanced market transparency due to centralised auctions/price discovery.
4. Risk of creating market bubbles + hurting investor certainty	
5. Managing transaction costs	Well-funded, a-political centralised approval reduces transaction costs and exploits economies of scale. Central auction makes project identification easier. (similar to NZ PRE scheme) Project methodologies build off existing Kyoto architecture.

4. Enhanced flexibility: Further questions

- Admin burden?
 - We can do better than an underfunded UN bureaucracy.
 - Can build/improve on existing project methodologies developed under Kyoto CP1
 - But NB to design systems that tailor cost to risk of error.
 - Economies of scale
- Risk management ?
 - Cohesion funds bears risk of overperformance.
 - Project developer bears risk of underperformance.
- What if no MS want to contribute to initial fund?
 - We think they will have an incentive to do,
 - But to insure against worst case 2% ETS reserve used to start CCH
 - To streamline EU funding for non-ETS, should be combined with a share of Cohesion Funds+EFRD funds prioritised for non-ETS sectors.
 - If MS do not contribute to funds, host MS have no AEA release obligation.

4. Implementing enhanced flexibility

- Which sectors? A number of non-ETS sectors are also potentially responsive to price signals (*at least to some extent*), despite being outside the ETS for reasons of scale/MRV:



Note a potential advantage of a price mechanism is that new methodologies / Innovations can be proposed..