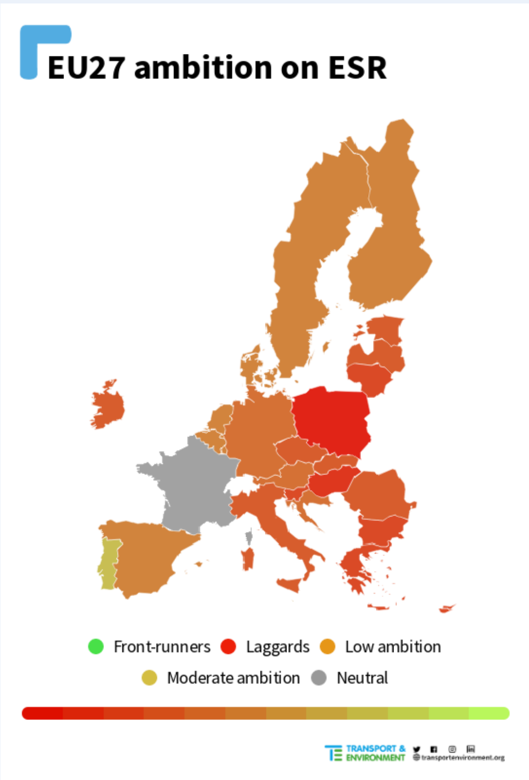
Council off track on the ESR

EU-27 ranking and recommendations for improvement

June 2022

Summary

In the following weeks, EU co-legislators are expected to adopt their position on the review of the Effort Sharing Regulation (ESR). This key climate legislation sets national emissions reduction targets in the sectors of road transport, buildings, agriculture, waste and small industry. Covering around 60% of the EU's total emissions, the ESR's contribution is crucial for the success of the Green Deal and the achievement of the EU-wide 2030 climate target. However, **the law is flawed and full of loopholes that will hollow out these national targets**. If countries use those loopholes to their full extent, the EU will **miss its 2030 goal for the ESR sectors by about 7 percentage points**.



Member states in the Council now have the opportunity to improve the law. **T&E looked into governments' positions on the 6 elements of the ESR currently discussed within the Council** to evaluate which countries are seeking to weaken or improve the regulation. By **ranking member states according to their ambition, or lack thereof,** this briefing suggests ways they can improve their stance.

The map shows that **no government was awarded a high score.** Even countries such as Denmark, Luxembourg, the Netherlands, Finland and Sweden - usually climate front-runners - scored poorly in this analysis. This is mostly due to their lack of opposition to the **French presidency's compromise on the emission reduction trajectory which would add the emissions of 20 million cars to the emissions budget of the next 8 years** (or 33 MtCO2eq). Poland, Hungary, Cyprus, Slovenia, Greece and Lithuania figure as laggards as they are seeking to enlarge existing loopholes and introduce new exemptions that would weaken national climate targets.

In order to preserve the environmental integrity of the regulation, it is essential that all governments agree to keep the emissions budget to the minimum and refrain from seeking ways out of their obligations.

1. Context

The Council of the European Union is due to adopt its position on the Effort Sharing Regulation (ESR) at the next meeting of EU environmental ministers on June 28th. The ESR is part of the EU's Fit for 55 package and sets binding national climate targets for 2030. Covering the sectors of road transport, buildings, agriculture, waste and small industries, it lays down the rules for around 60% of the EU's emissions. That makes it a key file to succeed in the transition towards a climate neutral continent. Ministers are discussing the Commission's July 2021 proposal to increase national targets in line with the EU-wide goal of reducing emissions by 55% in 2030 (compared to 1990). France is holding the rotating presidency of the Council until June 2022 and must broker a compromise between the 27 members of the EU. While it is essential that national climate targets are increased, T&E analysis has shown that the law is flawed and full of loopholes that will hollow out these targets.[1] If countries use these loopholes to their full extent, the EU will miss its 2030 target for the ESR sectors by about 7 percentage points. To prevent this from happening, T&E has identified 5 ways in which the Commission's ESR proposal can be improved:

1) Improving the integrity of the 2030 target (see in-depth briefing here)
2) Introducing a framework for binding national climate targets after 2030
3) Strengthening the compliance framework (see in-depth briefing here)
4) Ending the zero-rating of biomass
5) Bringing the Governance Regulation in line with the EU's new 2030 target

This briefing assesses the extent to which these improvements have been discussed in the Council. It identifies the gaps between what should be done and what decision-makers in the Council are heading towards. The evaluation aims to highlight which countries have been pushing to weaken or strengthen the Commission's proposal and suggests ways to improve countries' positions.

2. Methodology

This evaluation of member states' positions focuses on 6 key aspects of the ESR that are currently discussed by governments' representatives. Countries' positions are given points on the basis of their (mis)alignment with the most ambitious position identified by T&E. Having no position (or an unknown position) on an element is assigned 0 points, while maintaining a reservation is considered equivalent to agreeing with the status quo (current ESR or Commission's proposal text) and is awarded the

[1] Transport & Environment (2022). Fit to lose the climate challenge. Retrieved from https://www.transportenvironment.org/discover/fit-to-lose-the-climate-challenge/

corresponding points. For elements of particular significance to the climate integrity of the regulation, a multiplier is applied: a country's position on the emissions reduction trajectory is weighted 3 times, while positions on flexibility with the land use and forestry sector and with the EU carbon market are weighted 2 times.

Table 2 in the appendix displays how points are awarded to each stance and how countries are positioned, while the following paragraphs give a detailed assessment of countries' positions. The analysis is based on declarations made by ministers in Environmental Council meetings, bilateral meetings with national authorities, official documents of the Working Parties on Environment and papers submitted by national delegations to the presidency.

2.1. The emissions reduction trajectory

The key feature of the ESR is that it sets 2030 climate targets for each member state. Spain, Hungary, Slovakia, Bulgaria, Slovenia, Romania, Czechia and Latvia find their increased ESR targets too ambitious. **France** proposed to leave these targets intact, but **presented a compromise to change the emissions reduction trajectory towards those targets** in order to accommodate their position. The trajectory indicates the pace of the emissions reductions needed to reach countries' 2030 targets by setting annual caps on each country's emissions (Annual Emission Allocations or AEAs). The sum of these allocations identifies the 'carbon budget', the amount of climate-damaging gases that can still be emitted before the end of the decade, and is therefore as important as the actual targets.

The Commission proposed to review the emission limits for 2026-2030 in 2025 to account for a potential emissions rebound after the Covid-19 pandemic. Depending on the level of emissions in 2021-2023, countries' post-2026 emissions caps would be strengthened or weakened. For instance, if emissions in 2021-2023 are already significantly below the cap (as is the case of Czechia that received a generous allocation for 2021), the review in 2025 would result in a strengthened cap, and thus lower emissions, for the rest of the period. Overall however, the result of the Commission's methodology would be that the majority of EU member states would be allowed to increase their emissions in 2026. **The presidency is proposing to extend this looser emissions cap to all member states**. The emissions cap of a country would only be reviewed if that leads to a higher carbon budget. So while under the Commission's proposal the emissions budget of Czechia, Greece, Croatia, Italy, Luxembourg, Portugal, Poland and Romania would be shaved off in 2026, the French proposal leaves their emissions caps intact. **The result is that the French compromise would further worsen the Commission's proposal by the equivalent of 20 million cars on the roads**, as it increases the emissions budget by 33Mt[2].

No country has shown strong opposition against this amendment, nor has proposed a solution that would set a lower emissions budget and improve the Commission's text. Croatia, Cyprus, Czechia, Estonia, Finland, Germany, Hungary, Ireland, Italy, Lithuania, Slovakia and Slovenia support the presidency's proposal. Austria, Denmark, Luxembourg, the Netherlands and Sweden keep some

[2] The emissions budget under the trajectory of the compromise is given by the sum of the cumulative allocations of countries whose trajectory is reviewed (12 234Mt) and of the cumulative allocations of the countries whose trajectory is not reviewed (6 284 Mt), for a total of 18 818 Mt. For a comparison, the emissions budget under the Commission's trajectory is 18 785 Mt.

reservation on the compromise, but are not opposing it nonetheless. These five countries, as well as Finland and Germany, have however already set more ambitious climate targets at home.[3] They are giving in to other countries without demanding them to scale up their efforts as well. **By staying silent they are putting the EU-wide 2030 climate targets at risk.** We would at least expect these countries to strive for the so-called *'Trajectory C'*, a more ambitious alternative from the Commission's ESR Impact Assessment. This option has been proposed in the European Parliament by the EPP group (while the Greens, Left and Renew made even more ambitious proposals), therefore climate front-runners could aspire at least to that same level of ambition. It would require more gradual emissions cuts (i.e. no sudden increase or decrease of emissions caps) and would cut the equivalent of Italy's annual emissions from the emissions budget.

Poland is advocating to further worsen the French proposal through the creation of a new reserve of extra allocations and the increase of emissions caps in years when unforeseen events perturb emissions. This idea is backed by Cyprus, Greece, Ireland, Latvia, Hungary, Slovakia, Bulgaria, Slovenia, Lithuania, Estonia and Czechia. But the Regulation already contains plenty of instruments to face uncertainties and unforeseen events. There are processes to bank, borrow or transfer allocations, flexibilities with the carbon market and land-use sectors and additional allocations from the Safety Reserve. With this request governments are telling their citizens that climate action is expendable and not a priority to stick to for the sake of future generations.

2.2 Transfers between states

Under the ESR, countries can sell part of their emissions budget (AEA) surplus to other countries. These transfers incentivise cost-efficient emissions reductions across the EU and spur convergence between countries' climate efforts. In fact, lower income member states might be willing to overachieve on their targets if they receive the funding to do so from richer member states looking to buy surpluses.

Together with Denmark, Sweden, the Netherlands, Finland and Luxembourg, Belgium has put forward a proposal to increase the transparency of the AEA exchanges. Member states would have to share information on prices, quantities, terms of payment and type of transfers on an information platform. Belgium also proposed to create an auctioning platform for national AEAs, which would have incentivised price disclosure and enabled member states to have a clear understanding of where opportunities for cost-efficient emissions reductions lie. However, this latter proposal was not broadly taken on board by other delegations.

The French compromise on this point increases the share of emissions allocations that can be transferred and contains provisions to increase transparency. More transparency would be achieved in two ways:

[3] Sweden has already fixed in national law an ESR target of -63% by 2030 (compared to 1990). Finland has planned to become climate neutral by 2035. Denmark is going to cut economy-wide emissions by 70% by 2030. The Dutch government has included a -60% economy-wide 2030 target in its coalition agreement. Germany is aiming to achieve climate neutrality in 2045. The coalition plan of the Austrian government set the objective of climate neutrality by 2040. And Luxembourg has set a -55% 2030 target for the ESR sectors in its climate law.

- Countries must include more detailed information in the report they already submit to the Commission every year[4]. Namely on: quantities, type of transfers, prices. At the moment, member states must only give summary information (e.g range of prices).
- Before any transfer, a country must inform the Climate Change Committee (or CCC, established by the EU climate Law).

In principle all the Council members would favour more transparency on allocation transfers. However, Spain, Italy, Poland, Bulgaria, Lithuania, Slovakia, Hungary, Austria, Cyprus and Ireland are reluctant to provide information to the CCC before any transfer, fearing additional administrative burden and control by the CCC. Even so, **the text proposed by the presidency is the bare minimum.** The Belgian proposal to create an auctioning platform is preferable because it would facilitate exchanges between countries, price disclosure and easier financing of projects and programmes.

2.3. The off-setting with the land-use sector

Countries can use emissions removals credits from the land use and forestry sector when they have an AEA deficit. This mechanism would cumulatively add 262Mt to the ESR emissions budget and weaken the climate targets. What is more, net removals in the land use and forestry sector are hard to measure, are not equivalent to real emission reductions and are not permanent solutions (i.e. trees that are planted to remove CO2 from the air can be burned or cleared). To safeguard the ambition of the ESR, this loophole should be repealed.

In an attempt to limit the flexibility, the Commission proposed to split its use in half: 131Mt would be the maximum allowed usage in each of the two periods (2021-2025 and 2026-2030). **France is proposing to follow the Commission's approach.** Poland, Greece and Cyprus are against this, while the Netherlands, Sweden, Luxembourg, Cyprus, Hungary, Latvia, Slovenia, Romania, Lithuania agree to stick to the Commission's proposal. However, **none of the climate action front-runners are proposing to repeal it.** They are not even considering the less ambitious, but still better solution, to discount removal credits by half when used for ESR compliance.

Instead, **there are attempts to circumvent the weak limitations introduced by the Commission**. Cyprus wants to make it possible to transfer at least part of the removal credits from the first to the second period. Italy, supported by Czechia, Hungary and Romania, is proposing to use the LULUCF credits of the first 5 years to fill potential emissions gaps in 2030, under the condition that the limits of the Climate Law[5] are respected.

The Commission also proposed a new off-setting mechanism with the land-use sector. If member states accumulate net removal credits above their respective LULUCF targets for 2026-2030, they can choose to transfer them to an Additional Reserve. This Reserve could be accessed by a country only at the end of the

[4] According to Art 26 of the Governance Regulation (Regulation (EU) 2018/1999) every year EU countries must submit to the Commission a report on greenhouse gases inventories and the other information items listed in Annex V of the regulation.

[5] The Climate Law limits to 225Mt of CO2 the maximum contribution of net removals to the EU climate target for 2030.

ESR compliance period to fill its emissions gap, if all the other flexibilities have been used and the European Climate Law goal for 2030 is achieved.

One of the conditionalities to access the Additional Reserve is to not have sold more allocations than were purchased. France is proposing to lift this. Because of this safety net, a member state could sell all of its surplus to other countries without fearing to run out of credits or having to cut more emissions. The presidency proposal doesn't seem to cause any objection from national delegations. Only **Poland proposed an even less ambitious amendment.** It would make participation to the Additional Reserve mandatory and set a fixed percentage of net removals that would flow into the reserve to ensure credits are available in 2030.

2.4. Use of emissions allowances of the EU carbon market

Nine countries (BE, DK, IE, NL, LU, MT, AT, FI, SE) can choose to use a share of their allowances from the EU's carbon market (Emission Trading System or ETS)[6] to fill their emissions gap in 2030. This off-setting mechanism increases non-ETS emissions by a total of 100Mt and makes climate action in some sectors an alternative to cutting emissions in others. To increase ambition, it should be repealed from the Regulation.

The compromise proposed by the presidency doesn't significantly alter the text. It allows countries that didn't opt to use ETS credits so far[7] to still express their preference if they haven't done it. Where the current ESR text only allows countries to revise downwards their intended usage of ETS credits, the presidency proposal would also allow them to increase that portion.

Estonia, Cyprus, Czechia, Hungary, Slovenia, and Spain are demanding to extend the ETS flexibility to additional countries. Germany, usually a climate leader but currently not benefitting from this scheme, seems equally keen to explore the idea. This amendment would alter the balance of the contribution to emissions reductions between the ETS and non-ETS sectors. **None of the delegations suggested getting rid of this loophole altogether or limiting it.**

2.5. Call for convergence

The national climate targets are set at different levels of ambition in order to account for specific circumstances of each member state. As a result, Bulgaria should reduce its emissions by 10% by 2030 (compared to 2005 level), while Sweden by 50%. However, the European goal of climate neutrality by 2050 requires that all countries converge towards the same level of effort sooner or later. Only 13 countries have enshrined climate neutrality targets in their national law. The missing member states should do the same in order to start planning ahead and define their own path towards climate neutrality. If these countries fail to act now, it might become challenging and costlier for them to catch up later on.

[6] The eligibility has been limited to countries with a 2030 emission target above the average and above their cost-effective emission reduction potential.

[7] Eligible member states had to notify the Commission their intention to use this flexibility by 31 December 2019. Sweden and the Netherlands opted-out, while Belgium had decided to use less of the ETS flexibility than its legal maximum (1.89% instead of 2%).

Denmark, the Netherlands, Austria, Luxembourg, Finland, Belgium, Spain, Sweden and Portugal sought to include an amendment concerning the necessity to reach **convergence of national efforts over time**. In the presidency compromise, this ended up being **only a declaration of principle in the non-legally binding part of the ESR text.** What's more, to cater to the position of Estonia, Slovakia, Romania, Slovenia, Hungary and Bulgaria, a reference saying that convergence should take into account 'national circumstances' is made, which further weakens the text. **Luxembourg, the Netherlands, Denmark, and Sweden**, which all have climate neutrality targets in domestic legislation, and **Belgium**, are the only countries demanding to make the goal of convergence legally binding. However, they **are not pushing for the most ambitious solution: demanding that each EU country sets its own climate neutrality goal in national legislation[8].**

3. How the Council can improve its position

Countries' total score in table 1 in the Appendix shows that currently **no government is taking up a fight to safeguard the ESR ambition and strengthen national climate targets**.

As chair of the Council, France does not take a position. However, it is the declared objective of the French government to lead on climate ambition within the EU and to make the EU a global climate leader. **In striking contrast with such a stance, France has proposed rather unambitious options as starting points for finding compromises within the Council.** In what seems an attempt to soften laggards' positions, France has thus reduced the room of manoeuvre for improving the text since the beginning.

Countries such as Denmark, Luxembourg, the Netherlands, Finland and Sweden, usually front-runners in climate action, also score poorly for the ESR. This is mainly due to their lack of opposition (or proposal to improve) to the presidency's compromise on the emissions trajectory, even if it is going to inflate this decade's emissions budget by the extent of 20 million additional cars on the roads. Their lack of engagement in improving the ESR text is inconsistent with their own climate legislation which sets higher reduction targets at home[9]. Sweden and Luxembourg even supported a higher EU-wide 2030 climate goal than the net -55% that has been agreed in the Climate Law. Even if these countries are showing moderate ambition on some elements of the ESR (convergence of efforts and transfers of emissions allocations), they could significantly strengthen their position by:

- Rejecting the Commission's trajectory and the trajectory of the presidency compromise. A stringent trajectory would push countries with lower 2030 targets to step up their emissions cuts;
- Opposing any attempt to enlarge the loopholes of the ESR: existing loopholes and the creation of new flexibilities, as some delegations are asking for, would undermine the full achievement of the ESR targets that these climate ambitious countries support. Additional flexibilities also delay the laggards' climate action that is required to align countries' efforts across the EU;
- Advocating for the creation of a platform to enhance AEA exchanges;

[8] In practical terms, this would mean including in the ESR an amendment to the governance regulation. This piece of legislation set the rules governing climate and energy planning of EU member states.
[9] See note 3.

- Going beyond just a call for convergence: they could advocate to amend the Governance Regulation to include the requirement for all EU member states to adopt a national climate neutrality date in national legislation.

On the other side, Poland, Hungary, Cyprus, Slovenia, Greece and Lithuania rank as laggards because their positions weaken national climate targets. They could improve their position by refraining from all of these schemes that further delay mitigation or exempt them from the action that meeting their targets would require. **The distribution of the targets already took into account national circumstances such as economic output per capita and resulted in generous emissions caps for them.** Delaying emissions reduction further is against their own interest because the needed effort to decarbonise their economy by mid-century will still be required at a higher cost later on. By following a more stringent trajectory and by planning towards a long-term goal immediately, the emission reduction required is going to be more gradual.

Attempts to enlarge existing flexibilities and to create more exemptions are not only advanced by climate laggards like Poland, but also by countries that have more ambitious domestic policies - see for example the German position on extending the flexibility with the ETS. Only Portugal is being moderately ambitious, even if the lack of information on its position on the emission reduction trajectory makes its scoring incomplete. In order to preserve the environmental integrity of the regulation, it is essential that all governments refrain from seeking ways out of their efforts and agree on keeping the emissions budget to the minimum.

What's happening in the European Parliament

In the meantime, on May 17th the ENVI committee adopted its report on the ESR agreeing to fix some flaws of the Commission's proposal to review the ESR. The Committee decided to:

- Adopt the option 'C' for the trajectory and introduce limits on the use of flexibilities.
- Give more teeth to the process to correct countries' course of action if they are not progressing well towards their reduction targets. This way governments are not let off the hook.
- Give EU citizens the right to bring their government to court if they miss their climate targets.
- Stop falsely assuming the emissions from the burning of unsustainable biomass as zero under the ESR.

Other needed changes are missing:

- The loopholes with the land use and emission trading sectors and the possibility to get additional permits to pollute - via the so-called Safety Reserve - remain there. These loopholes are especially problematic as they reduce emissions cuts in the ESR sectors, hollowing out national targets.
- The decision of not setting the rules to adopt ESR targets for 2035 and 2040 and national climate neutrality targets is short-sighted and puts the continuation of national climate targets at risk.

Find out more on T&E position here.

Appendix: detailed results and additional information

Table 1: member states' total score on the ESR

Member states are grouped in ranges on the basis of their total score: laggards (-30;-16), low ambition (-15;-1), moderate ambition (1;15), front-runners (16;30). A score equal to 0 corresponds to insufficient information on that country's position. As it holds the rotating presidency of the Council, France is considered neutral and not awarded a score.

Country	Score	Group	Country	Score	Group
PL	-21	Laggard	IE	-11	Low ambition
HU	-19	Laggard	AT	-9	Low ambition
CY	-17	Laggard	HR	-7	Low ambition
SV	-17	Laggard	DE	-6	Low ambition
EL	-16	Laggard	ES	-5	Low ambition
LT	-16	Laggard	FI	-4	Low ambition
LV	-14	Low ambition	BE	-2	Low ambition
BG	-13	Low ambition	DK	-1	Low ambition
EE	-13	Low ambition	LU	-1	Low ambition
IT	-13	Low ambition	NL	-1	Low ambition
CZ	-12	Low ambition	SE	-1	Low ambition
RO	-12	Low ambition	MT	0	Unknown
SK	-12	Low ambition	PT	2	Moderate ambition

Table 2: points awarded to countries' positions

For elements of particular significance to the climate integrity of the regulation, a multiplier is applied: countries' positions on the emissions reduction trajectory are weighted 3 times, while their positions on flexibility with the land use and forestry sector and with the EU carbon market are weighted 2 times. As it holds the rotating presidency of the Council, France is considered neutral and not awarded points.

ESR element	Tabled positions	Points awarded	Countries' positions
Emission reduction trajectory	Trajectory C	3	
	Unknown	0	MT, PT, ES
	Commission's proposal	-3	AT, DK, LU, NL, SE, BE
	Presidency compromise	-6	HR, FI, DE, IT, RO
	Poland's proposal	-9	BG, CY, CZ, EE, EL, HU, IE, LV, LT, PL, SK, SV

Transfers between member states	Auctioning platform	3	BE
	Information platform	2	DK, FI, LU, NL, SE
	Presidency compromise	1	HR, CZ, EE, DE, LV, MT, PT, RO
	Unknown	0	EL
	Less ambitious	-1	AT, BG, CY, HU, IE, IT, LT, PL, SK, SV, ES
Flexibility with the carbon market	Repeal	6	
	Presidency compromise	-2	All other delegations
	Extension	-6	CY, CZ, EE, HU, SV, ES, DE
Flexibility with the land use and forestry sector	Repeal	6	
	Discount of net removal credits	4	
	Presidency compromise	2	FI, DE, LU, NL, PT, SE
	Unknown	0	BE, BG, HR, CZ, DK, EE, IE, MT, SK, ES
	Italy's proposal, Cyprus proposal or against limitation	-4	AT, CY, EL, HU, IT, LV, LT, PL, RO, SV
Additional reserve	Delete	2	
	Unknown	0	AT, CY, DK, DE, IE, MT, PT, SV
	Commission's proposal	-1	HR, CZ, IT, LV, LT, SK, ES
	Presidency compromise	-2	BE, BG, EE, FI, EL, HU, LU, NL, RO, SE
	Poland's proposal	-3	PL
Convergence	National climate neutrality targets	3	
	Binding convergence goal	2	SE, BE, LU, NL, DK
	Presidency compromise	1	All other delegations
	Against	-3	PL

Further information

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