European Commission

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	*Amendment of Regulation (EU) 2018/842 on binding annual greenhouse gas reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement*
LEAD DG (RESPONSIBLE UNIT)	CLIMA.C2 Governance & Effort Sharing
LIKELY TYPE OF INITIATIVE	Legislative, through the ordinary legislative procedure
INDICATIVE PLANNING	Q2 2021
ADDITIONAL INFORMATION	https://ec.europa.eu/clima/policies/effort/regulation_en

The Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

The European Green Deal[1], adopted by the Commission in December 2019, has tackling climate change, including more ambitious action in the coming decade, and reaching the objectives of the Paris agreement and other environmental issues at its core. This transition must be just and inclusive. The climate neutrality objective, which the Commission proposed in 2018[2] and the European Council[3] and Parliament[4] endorsed, is one of its central elements. The Commission has proposed to enshrine climate neutrality into EU law[5]. In order to set the EU on a sustainable path to achieve climate neutrality by 2050, with the Communication on stepping up Europe’s 2030 climate ambition[6] the Commission has proposed an EU-wide, economy-wide net greenhouse gas emissions reduction target by 2030 compared to 1990 of at least 55% and set the stage for this initiative, together with other legislative initiatives in the field of climate and energy.

To this end the Commission will review the relevant climate-related policy instruments. This includes the Regulation on binding annual greenhouse gas (GHG) reductions by Member States, the so called Effort Sharing Regulation[7] (ESR). This regulation covers currently all GHG emissions which are not covered by the EU Emissions Trading System (ETS) nor by the Regulation on Land-Use, Land-Use Change and Forestry (LULUCF) and defines targets, flexibilities and compliance rules. Introducing emissions trading for a significant share of the existing effort sharing sectors and perhaps folding agricultural non-CO_2 emissions into the land use sector (one of the possibilities envisaged in the Communication on stepping up 2030 climate ambition[8]) would have substantial consequences for this Regulation. This initiative will look at different options in light of an expansion of emissions trading and potential changes and ongoing reviews of other related pieces of legislation, e.g. on energy efficiency in buildings and mobility. This initiative will take into account the potential impacts of the COVID-19 crisis and recovery.

Problem the initiative aims to tackle

The current 2030 climate ambition of at least 40% emissions reductions compared to 1990 and the corresponding current ESR ambition of reducing non-ETS emissions by at least 30% compared to 2005 is inconsistent with

1 COM(2019)640 final.
2 COM(2018)773 final
3 European Council conclusions, 12 December 2019.
4 European Parliament resolution of 14 March 2019 on climate change and resolution of 28 November 2019 on the 2019 UN Climate Change Conference in Madrid, Spain (COP 25).
5 COM (2020)80 final
6 COM (2020) 562 final
7 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.156.01.0026.01.ENG&toc=OJ:L:2018:156:TOC
8 COM(2020)562 final

reaching climate neutrality by 2050. For the effort sharing sectors, in particular in transport and buildings, decisions today or in the near-future will have long-term implications, e.g. around 15 to 20 years for cars if second hand use is included and for the deep renovation of old buildings, and up to 50 years and longer for new buildings. Hence, it is important that the 2030 ambition level for the effort sharing sectors is consistent with the 2050 climate neutrality objective and the impact assessment will analyse corresponding ESR policy options. The impact assessment will also analyse how the COVID-19 crisis is affecting the problem, as notably the transport sector as the largest effort sharing sector is significantly affected by the crisis. This may hamper the necessary investments. It will also assess distributional impacts between Member States of increasing ambition.

Another issue that is crucial for the effective decarbonisation of the sectors concerned is to ensure the continuation of a coherent regulatory and incentive architecture for the current effort sharing sectors, i.e. road transport, buildings heating, agriculture CO_2 and non-CO_2 emissions, small industrial installations and waste management. These are sectors which cover mainly small emitters, and in which Member State legislation has a significant role to play in view of differing national circumstances. Coherence with the changes proposed for the revision of the ETS and its possible extension, of the LULUCF framework and its link to agriculture, of the Energy Taxation Directive, and of the frameworks for renewable energy and energy efficiency, notably the Energy Efficiency Directive and Energy Performance of Buildings Directive, needs to be ensured. Also maintaining appropriate incentives for complementary national policies will be important.

Basis for EU intervention (legal basis and subsidiarity check)

The legal basis of this initiative is in Article 192(1) of the Treaty on the Functioning of the European Union (TFEU).

Climate change is a transboundary problem, where coordinated EU action can supplement and reinforce national and local action effectively. Coordination at the European level enhances climate action and EU action is justified on grounds of subsidiarity, in line with Article 191 TFEU. The EU has worked since 1992 to develop joint solutions and drive forward a global agreement to fight climate change.

Action at EU level is therefore indispensable, and coordinated EU policies have a much bigger chance of leading to a true transformation, particularly in light of the global dimension of the challenge. This approach must take into account different mitigation potential between Member States, as well as the EU single market as a strong driver for cost-efficient change and upward convergence.

B. Objectives and Policy options

The **objective** of this initiative is to review the Effort Sharing Regulation and align the regulatory framework to an EU-wide target to reduce net emissions by at least 55% in 2030 compared to 1990 levels and with the goal of achieving climate neutrality by 2050. More specifically, incentives for the necessary additional action in the effort sharing sectors should be provided, cost-effective solutions should be promoted, Member States' efforts should be shared in a fair and consistent manner, and coherence with related legislation should be maintained.

The **baseline** for this initiative is the current Effort Sharing Regulation. The Regulation sets national emission reduction targets which for 2030 vary between 0% and -40% compared to 2005 mainly based on economic capacity, i.e. GDP per capita, and taking into account cost-effectiveness in a fair and balanced manner. It includes a range of flexibilities: Emission allocations can be banked and borrowed with certain limitations. Transfers of allocations between Member States are possible and only restricted ex ante for sellers. There are also limited flexibilities with the ETS and LULUCF. There is a compliance cycle in five-year intervals with non-financial penalties for non-compliance.

This initiative will investigate further options to amend the Effort Sharing Regulation to ensure a consistent implementation of stepping up Europe's 2030 climate ambition:

Option 1: Phase out the Effort Sharing Regulation as a consequence of extending emissions trading and merging both the non-energy related ESR emissions from agriculture and the GHG emissions/removals under the LULUCF Regulation under a single climate policy instrument

This option considers the combined effort sharing implications of extending the ETS to all fossil fuel combustion emissions and of LULUCF option 3. The latter implies that the GHG-inventory sectors that are more closely related to the bio-economy (i.e. agriculture and LULUCF) are combined in a single climate policy instrument, with its own climate objectives and rules to devolve and reflect these objectives onto private actors.

For the remaining non-ETS and non-bioeconomy sectors a repeal or gradual phasing out of the ESR would require that remaining emissions are covered by sufficiently stringent and effective regulations once this takes place. EU legislation has been rather successful in the context of waste emissions, while waste emissions from water treatment installations would need to be included. For F-gases, EU regulations already exist which need to be further strengthened. Whereas methane emissions from coal, oil and gas facilities have often a win-win reduction potential, no EU regulation exists yet that reduces their climate footprint. The recent methane emission reduction strategy proposes legislative and other actions. Likewise, CO_2 standards for vehicles, accompanied by the deployment of recharging and refuelling infrastructure, will remain a core instrument to decarbonise road transport.

Option 2: Keep current ESR sectoral scope in parallel to extending emissions trading

Under this option, all of the current ESR sectors to be gradually covered by expanded emissions trading or a new integrated land-use/agriculture policy instrument would remain also under the ESR. As one variant, the 2030 ESR ambition level would increase in accordance with the overall GHG ambition. Correspondingly, Member States' targets would need to be increased, and different sub-options how to do this adjustment will be looked at. Also the impacts of adjusting flexibilities including with ETS and LULUCF will be analysed. Different criteria including fairness and solidarity and cost-effectiveness will be considered so that all Member States would participate in the effort, taking into account national circumstances. The other variant of not increasing Member States' targets, and putting the additional efforts on emissions trading (either on newly or existing ETS covered sectors), on LULUCF sectors and/or sector specific policies, corresponds in legal terms to the baseline. It will be analysed what impact the changes in other policies would have.

Other relevant and related policy initiatives are e.g. the reviews of the Renewable Energy, Energy Efficiency and Energy Performance of Buildings Directives, of the CO_2 and cars Regulation, of the Alternative Fuels Infrastructure Directive, as well as the reform of the Common Agricultural Policy, the Renovation Wave, the Circular Economy Action Plan, Next Generation EU, the Sustainable and Smart Mobility Strategy and the Farm to Fork strategy. Other policies that drive improvements in the efficiency of the transport sector and greater use of sustainable transport modes will also contribute.

Option 3: Maintain in the ESR only the sectors not covered by emissions trading

Depending on the choices made in relation to a possible extension of emissions trading to other sectors, under this option the ESR would have a significantly reduced scope. If emissions trading covers all fossil fuel combustion emissions, emissions still covered by the ESR could amount to about one third of emissions currently covered and consist only of agricultural non-CO_2 emissions, energy related non-CO_2 emissions (methane emissions from coal mines and pipeline leaks, and emissions associated with the combustion of fuels), some industrial process emissions, F-gas leaks from manufacturing products like air-conditioning, and methane emissions from waste and wastewater. If, in addition, agriculture would be combined with LULUCF but the ESR maintained, its scope would reduce at one extreme to one sixth of emissions currently covered. At the other extreme of no ETS extension, the ESR would have the same scope as today.

The impact assessment accompanying the Communication on stepping up 2030 climate ambition concluded that this option might require a moderate target increase at EU level compared to the current ESR, while the reduced sectoral scope might require adjustments to setting national targets. Also the impacts of adjusting flexibilities including with ETS and LULUCF will be analysed (see also above described considerations on criteria). As few other instruments currently put binding requirements on emissions in the remaining sectors, the need for adapted compliance rules providing stronger ex ante incentives for compliance will be assessed.

The relevance of the related policy initiatives mentioned under option 1 and 2 would depend on the ESR scope.

As ESR related planning, monitoring and reporting requirements are set under the Regulation on the Governance of the Energy Union and Climate Action, related implications of the three policy options will require consideration.

C. Preliminary Assessment of Expected Impacts

Likely economic impacts

The impact assessment for stepping up 2030 climate ambition includes a first analysis of economic impacts.

More ambitious ESR targets as under options 2 and 3 would require Member States to develop and implement sufficiently stringent additional national policies in the corresponding ESR sectors covered. This would create economic impacts for the sectors covered.

Option 2 would then imply additional ESR induced efforts for the buildings and transport sectors, e.g. due to national measures with respect to overcoming non-price barriers to renovation, national taxation, the provision of infrastructures and to the choice between different modes of transport. It will need to be analysed if the coexistence of appropriately defined national reduction targets and flexibilities would interfere with the cost-efficiency focus of the ETS. At the same time it would contribute to mitigate upward pressure on the ETS carbon price and related economic impacts. COVID-19 economic impacts might make it more challenging to leverage the necessary complementary national investments in transport and buidlings.

Depending on the choices made about the agricultural sector (merge it with the LULUCF sector under ESR option 1, or maintain it as the largest ESR sector under ESR option 3), the respective targets may affect Member States in different ways depending on their land use profiles (e.g. relative importance of food and biomass production, vulnerabilities to climate change). The impact of alternative target distribution mechanisms will be analysed as part of the LULUCF impact assessment and relevant results will be taken into account for the analysis of ESR target distribution criteria and flexibilities under ESR option 3.

Also the possible mitigating effects of temporarily lower emissions due to COVID-19 and related possible surpluses in early years on achieving tighter targets in later years of the 2021-30 period will be analysed.

Likely social impacts

The impact assessment for stepping up Europe's 2030 climate ambition has analysed social impacts such as employment and household income. The analysis needs to be extended to distributional impacts between Member States of sharing efforts on an increased ESR ambition level by increased national 2030 emission reduction targets. A key distinction for several ESR elements is differing per capita income levels across Member States. It needs to be studied if double coverage of sectors in ESR and ETS could lead to additional distributional impacts between Member States depending on whether the national ESR targets would be significantly less or more stringent than ETS induced reductions. Social and distributional impacts will be analysed at Member State level for all relevant options. These will take into account the Member States' emission reductions stemming from planned policies in the national energy and climate plans.

The impact assessment will also need to consider that the EU budget together with the Next Generation EU package and the related proposed national recovery and resilience plans can be a strong driver for transformation and leverage sustainable private and public investment. These can also help ensuring a just transition, if resources are well-deployed, and designed in a way to address distributional issues between Member States.

Likely environmental impacts

For option 1, strong EU and/or national policies to reduce methane emissions from energy production and industrial, domestic and road transport energy use, F-gas and waste emissions will become crucial to maintain the necessary regulatory incentives.

Keeping the current ESR scope while delivering on the increased climate ambition (option 2) would incentivise additional policies by Member States complementary to the carbon price to achieve e.g. the required significant increases of energy efficiency, renewable energy, and electrification of buildings and transport. The emission decrease in the sectors covered by the Effort Sharing Regulation (ESR) in line with 55% net GHG emission reductions would be around 40% compared to 2005, an increase by around 10 p.p. to current aggregated national ESR targets. Appropriate compliance provisions could further increase incentives and by this the certainty to achieve these reductions.

If the scope of the ETS were to be extended to fossil fuel use in both buildings and road transport and taken out of the ESR scope (option 3), the necessary ESR emission decrease would be around 35 % excluding buildings and road transport, or around 32% if all energy-related CO_2 emissions would be excluded. The Regulation would then predominantly cover non-CO_2 emissions.

Positive impacts can be expected on air quality and human health as a result of reducing GHG emissions from combustion, correlated with other air pollutants.

For more details on the preliminary analysis see sections 6.3.1, 6.7.1 and Annex 9.7.1 of the impact assessment for stepping up the EU's 2030 climate ambition.

Likely impacts on fundamental rights

This initiative advances environmental protection, in line with Article 37 of the Charter of Fundamental Rights of the European Union[9], pursuing a high level of environmental protection and the improvement of the quality of the environment.

Likely impacts on simplification and/or administrative burden

The 2016 impact assessment for the Effort Sharing Regulation (SWD/2016/247) has shown that the administrative costs related to implementing the regulation are limited. While option 3 is not likely to have additional adminstrative impacts, these are likely to differ for the other options.

Option 1 would reduce the administrative burden to ESR implementation for Member States, and replace it by the burden for Member States and companies to implement the new policy framework.

For option 2 there would be some administrative impacts resulting from the ETS coverage of certain sectors, while maintaining them in the ESR. First, ESR administrative rules would continue to apply. However they are generic and the administrative costs related to ESR implementation are limited and are independent from the emission scope, as they always start from GHG inventory emissions deducting (or not) emissions covered by the EU ETS. Second, there may be complexities resulting from differences in emission calculation methods under the EU ETS and under the GHG inventories. This will need to be further analysed but there is experience from dealing with such issues and related risks for ESR compliance for the industry sector, where such calculation methods differ more strongly.

D. Evidence Base, Data collection and Better Regulation Instruments

9 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12012P/TXT

Impact assessment

The impact assessment will build on the Communication on stepping up 2030 climate ambition and its supporting Impact Assessment. It will assess economic, social and environmental impacts of the outlined options, including at Member State level, also in view of the COVID-19 crisis and recovery. It will be prepared in coordination with other relevant impact assessments part of the same package.

Evidence base and data collection

This initiative builds for some aspects upon evidence gathered in the previous impact assessment for the ESR Regulation in 2016and for the Communication on stepping up 2030 climate ambition, and any relevant evidence compiled in other concurrent Green Deal initiatives.

In addition, an updated Member State specific EU Reference Scenario which includes COVID-19 impacts will allow to further update policy scenarios. These will support the option analysis, building upon the scenarios developed for the Communication on stepping up 2030 climate ambition. Also results of a support contract on the extension of the ETS, which includes an analysis of ESR impacts of different extension options, will be used.

Consultation of citizens and stakeholders

A first set of stakeholder views has been collected between 31 March and 23 June 2020 as part of the open public consultation on Stepping up the EU's 2030 climate ambition. With a subsequent consultation the Commission will seek stakeholder views, opinions and preferences on the range of issues and design choices for a reviewed ESR. Main stakeholders include national, regional and local governments, trade and professional organisations, social partners, NGOs, and research and academic institutions The consultation will consist of:

- Collecting online feedback on this inception impact assessment over a 4-week period
- A 12-week open online public consultation consisting of a questionnaire of multiple choice and open questions, as well as the opportunity to submit open feedback
- Welcoming the submission of stakeholder documents such as position papers, policy briefs or roadmaps

Will an Implementation plan be established?

As the ESR is a regulation which shall only be reviewed in a targeted way, no implementation plan is necessary.