The ESR Safety Reserve

Double trouble with a second distribution round

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In a nutshell

- The Safety Reserve reduces the incentive for Member States to make additional emissions reductions and for transfers within the ESR.
- Both the Council and the Parliament support the establishment of such a Reserve. It is therefore important that the design features reduce the negative impacts as much as possible.
- The overall Reserve size is slightly larger under the Council position (115 million) than under the Parliament (90 million). However, to focus on this difference is a distraction from something that has a far greater impact: the introduction of a second distribution round under the Council Position.
- To prevent the Safety Reserve from further diluting the incentives for additional reductions and cooperation between member states, **we urge policymakers not to allow a second distribution round, or to at least limit it**.

About Sandbag

Sandbag is a London and Brussels-based not-for-profit think tank conducting research and campaigning for cost-effective climate policies.

Our research focus includes accelerating the phase-out of old coal in Europe; reforming the EU Emissions Trading System and the Effort Sharing Decision; and deep decarbonisation of industry through technologies including Carbon Capture & Storage.

For more information, visit sandbag.org.uk or email us at info@sandbag.org.uk

Why we don't need a Safety Reserve

In our briefing "*Too Safe to Succeed*", we have showcased how only very few eligible Member States would actually get access the Safety Reserve. Both under the Council position as well as the EP position on the starting point, only four Member States would need access to the reserve under a Business as Usual scenario. **Due to modest and highly differentiated targets, all other eligible Member States would have a cumulative surplus over the period 2021-2030, and would not have need for the Reserve**.

The Safety Reserve also undermines the incentives for beneficiary Member States to go beyond business as usual emissions reductions – either domestically or through cooperation with other Member States. Instead of making the effort of pursuing additional reductions, they will have incentives in the short term to sit back and count on the Safety Reserve to achieve compliance.

For these reasons, it would be best not to have a Safety Reserve at all. However, since both the Council as the European Parliament agree that such a Reserve is necessary, it is important to reduce the negative impacts as much as possible.

Designing the Safety Reserve: why the volume is not the only issue

The functioning of the Safety Reserve under the Council and the EP position is quite similar: it will only become available subject to the achievement of the 2030 target, the overall volume will be distributed based on the level of overachievement in the current period (2013-2020), and Member States can only access it to the extent they need it

for compliance, after exhausting their own ESR budget (with no net-transfers to other Member States) and LULUCF flexibility.

However, the position of both institutions differs on two key elements.

- Firstly, the EP position caps the total volume of the reserve to 90 million tonnes, whereas the Council position increases this to 115 million tonnes.
- Secondly, the Council position introduces a second distribution round: if a Member State wouldn't need its (full) share of the Reserve for compliance, then this unused share is redistributed among Member States that still face a deficit after the first distribution round.

Intuitively, the best way to limit the negative impacts of the Safety Reserve seems to be to limit the overall size of the reserve. However, our analysis finds that the introduction of a second distribution round has a far greater impact on the amount of allowances that could actually be used from this reserve.

Expected balance and potential use of the Safety Reserve (in Mt CO2eq.)

	Balance under REF (after LULUCF)[1]	Potential use of the Safety Reserve			
Size → **2nd round?**		90 million Yes	90 million No	115 million Yes	115 million No
BG	9	0	0	0	0
HR	14	0	0	0	0
CY	-1.5	1.0	0.8	1.2	1.0
CZ	39	0	0	0	0
EE	8	0	0	0	0
EL	98	0	0	0	0
HU	85	0	0	0	0
IT	-103	49	22	62	28
LV	11	0	0	0	0
LT	5	0	0	0	0
MT	3	0	0	0	0
PL	-71	29	8	38	10
PT	43	0	0	0	0
RO	60	0	0	0	0
SK	-24	10	3	13	4
SI	10	0	0	0	0
ES	54	0	0	0	0
Total		**90**	**34**	**115**	**43**

Our analysis clearly demonstrates that the introduction of a second distribution round has a far greater impact than the overall size of the Reserve (when using the range of 90 to 115 million). That is because with just one

[1] The balance is based on the starting point under the Council position. The 2016-2018 average emissions are based on most recent WEM projections. The emissions for 2021-2030 are based on the Commission's REF scenario. It is assumed that Member States can generate enough LULUCF credits to make maximum use of the LULUCF flexibility. The balance is different when using the EP starting point. However, this has no impact on the access to the Safety Reserve (the Member States with a positive balance under the Council starting point still have a positive balance under the EP starting point, although smaller in some cases)

distribution round, a large share of the Reserve won't be used as most eligible Member States won't need it. With a second distribution round, the full amount of the Reserve will be used up by just a few Member States.

Our analysis also shows that with a second distribution round, those few eligible Member States that could use the Reserve will be able to cover more than half of their expected deficit under Business as Usual. In other words, the second distribution round would halve additional effort they would have to do beyond Business as Usual. This clearly undermines the incentive to reduce, either domestically or through cooperation with other Member States.

Recommendations

The optimal solution would be to limit the overall cap on the Safety Reserve as much as possible and to prevent a second distribution round of unused credits. However, if a trade-off has to be made, the focus should be on the second distribution round. In other words, **it's still better to have a slightly larger Safety Reserve with just one distribution round, than a smaller Reserve with a second distribution round**. A third best option would be to cap the access for each Member State in the second distribution round, e.g. at 20% of that Member State's overachievement in 2013-2020[2].

Our recommendations are therefore:

- ➔ Limit the access to the Safety Reserve to one distribution round. The introduction of a second distribution round risks giving just a few Member States a very large extra allowance supply;
- ➔ Limit the overall cap on the Safety Reserve as much as possible, to further reduce its negative impacts;
- ➔ If a second distribution round would be included after all, put a limit on the access a Member State could get in that distribution round (e.g. at its original access to the reserve, before applying a pro rata reduction).

[2] The Council's position limits the initial share of each Member State at 20% of its overachievement in 2013-2020. If necessary, a pro rata reduction is applied to ensure the aggregate volume does not overachieve the total limit (115 million). However, it does not impose any cap on the second distribution round. Therefore a Member State could use more credits from the reserve than its initial share (calculated as 20% of its overachievement in 2013-2020).

About this briefing

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