



## Denmark's position paper on an ambitious EU 2040 climate target and a cost-effective EU climate architecture – a response to the public consultation on the European Commission's 2040 Climate Target

### Denmark's main priorities for the 2040 Climate Target and implementing climate architecture

#### **2040 EU Climate target:**

- The EU's 2040 climate target needs to be in line with the long-term goal of 1.5 °C and ensure that the EU is on the right trajectory to reach climate neutrality by 2050 at the latest and aiming to achieve negative emissions thereafter.
- The proposal for a new 2040 target should also include an EU 2035 target in accordance with the five-year timeframes for Nationally Determined Contributions decided at COP26.

#### **Cost-effective EU climate architecture based on three main pillars:**

- An EU Emissions trading system for all emissions from energy consumption and industry to ensure a cost-effective transition with a consistent CO<sub>2</sub> price signal across the economy. This should include integration of negative emissions on conditions of credible accounting, long-term storage and sustainability.
- An agricultural pillar with a common EU target for agricultural emissions (including net emissions from agricultural land), achieved to the greatest extent possible through emissions trading and underpinned by EU-wide climate and environmental sectoral regulation and an EU common agricultural policy with a greater focus on climate and environment.
- A forestry pillar with common EU regulation of emissions and removals from forests and other land use.

#### **Supported by:**

- An ambitious and coherent climate and energy framework with EU-wide enabling sectoral standards that contributes to a cost-effective reduction effort and technology development. This should include an assessment of existing regulatory instruments, including whether the nature and extent of current national obligations and sectoral targets are fit for addressing the EU's challenges beyond 2030.
- Strengthened leakage protection for emissions covered by emissions trading in the EU at risk of leakage through measures such as the EU's carbon border adjustment mechanism in full accordance with WTO rules.

### **A 2040 EU GHG reduction target in line with the the long-term temperature goal of 1.5 °C and the EU's climate neutrality objective**

At COP26 in Glasgow in 2021, all Parties to the Paris Agreement resolved to pursue efforts to limit the temperature increase to 1.5 °C. At COP30 in 2025, the Parties will communicate new climate commitments for the period after 2030 through updated Nationally Determined Contributions. The latest assessment report of the Intergovernmental Panel on Climate Change underlines the scale of the challenge. Global warming is set to bring and intensify a number of adverse effects, including extreme weather events, droughts, flooding and economic damages.

The EU must present a strong and credible response to the challenge and take on a leading role in keeping the goal of limiting global warming to 1.5 degrees within reach. The need to combat climate change is more important than ever. We should therefore step up EU's climate efforts and secure an ambitious EU 2040 target to put the EU at the forefront globally. It is crucial that the EU sends a strong political signal to the European citizens and the world that the EU leads by example to inspire and encourage other large emitters to follow suit, as well as to ensure the necessary increase in global climate ambitions at COP30.

This will require setting an ambitious EU economy-wide net greenhouse gas emissions reduction target for 2040 in line with the long-term temperature goal of 1.5 °C and which ensures that the EU is on the right trajectory to reach climate neutrality by 2050 at the latest and aiming to achieve negative emissions thereafter. To be in line with the five-year timeframes for NDCs, decided at COP26, the Commission's communication on an EU 2040 target should also include an EU 2035 target.

Along with a deep, rapid, and sustained effort to reduce greenhouse gas emissions, a substantial amount of removals of CO<sub>2</sub> from the atmosphere is needed as the EU approaches climate neutrality. It is important that the EU's climate effort is designed to incentivise this in the most cost-effective way. The environmental integrity of removals should be obtained by the right regulatory framework and credible MRV schemes.

#### *Incentivise climate action in a feasible and cost-effective way*

A higher climate ambition beyond 2030 requires a cost-effective EU regulation to ensure that an ambitious transition is feasible and provides the right incentives to reduce emissions of greenhouse gases across all Member States and sectors of the European economy. It is a key task of EU's climate policy that all Member States are able to reap the benefits of the green transition. EU can only lead by example if we continue to show our citizens, enterprises and the world that the implementation of higher ambitions can be achieved in a way that is economically sustainable, socially balanced and ensures cohesion within our societies.

Denmark therefore encourages the Commission to provide in its communication an overall direction for how the EU's climate regulation can be designed in a more cost-effective way to be fit for a climate neutral future. European industry, business, citizens and Member States are facing decisions on investments in new production facilities, energy generation, transportation modes, food production and infrastructure that will lay the foundation for the EU's ability to deliver greenhouse gas reductions towards 2040 and beyond. Clarity and certainty on the post 2030-regulatory framework will be necessary to guide future investments in green solutions and the necessary expansion of infrastructure.

An ambitious EU climate target backed by effective policies will also be crucial to safeguard EU's resilience and energy autonomy, not least by incentivising a faster expansion of renewables. EU's climate policy should contribute to EU's security and industrial policy ambitions by strengthening the EU's energy independence, security of supply and green industrial production capacity. It will strengthen the competitiveness of EU's industry and the EU domestic development and manufacturing of net-zero technologies, putting the EU at the forefront of the global race. In addition, it will also bring multiple benefits to EU's citizens such as cleaner air, reduced pollution, and future-proof employment opportunities in green sectors and industries.

*The Fit for 55 package is a major step forward in the right direction...*

The EU has taken an important and decisive step towards a more cost-effective climate regulation architecture with the Fit for 55 package. The expansion of emissions trading and EU-wide sectoral standards provide clear rules and a level playing field for businesses across the EU and a high degree of certainty for delivering the needed reductions.

*... but unresolved challenges remain*

While carbon pricing and EU standards are set to drive cost-effective emission reductions from fossil fuels and industry, new challenges are likely to mount towards 2040 not least, if we follow the same path based on the existing regulatory architecture. Challenges, which will be necessary to address in the EU's post-2030 climate and energy regulation include:

- The division of the EU ETS into two separate systems with a number of price-limiting mechanisms reduces its overall efficiency, cost efficiency and reduction potential.
- The EU climate regulation does not provide market-based economic incentives for carbon removal technologies.
- Sectors regulated through national targets in the LULUCF and the Effort Sharing Regulation have significant differences in the marginal reduction costs between Member States, which makes the transition more costly than necessary. Nationally binding targets have so far been less efficient in delivering emission reductions and lack transparent and effective monitoring and compliance mechanisms compared to EU-wide regulation.
- The climate impact of the agricultural sector is only regulated through nationally differentiated targets, which distorts competition, increases the risk of carbon leakage,

creates discrepancies in reduction efforts across Member States and delivers limited climate effects.

- As the EU's energy system decarbonises towards 2040 and the need to ensure EU's energy autonomy has become paramount new challenges arise. The necessary build-out and integration of renewable energy resources at the scale needed requires a more coherent and comprehensive EU approach to infrastructure, demand management and energy storage as well as effective EU-wide energy markets fit for a net zero energy system.

The Commission's communication on the EU 2040 Climate Target provides an opportunity to review the design and overall architecture of the EU's energy and climate policy. Postponing this task will make the transition more costly, slow the green transition and jeopardise our commitment to reach climate neutrality by 2050 at the latest.

#### *A revised climate architecture fit for purpose*

In Denmark's view, the appropriate response to these challenges is to strengthen and extend carbon pricing to be the primary instrument for ensuring delivery and compliance of the EU's climate target. As it is already the case for the sectors in the current Emissions Trading System (ETS), there is no need for unnecessary double regulation through nationally binding targets in the Effort Sharing Regulation. This is neither beneficial for the climate nor the EU's economy as a whole.

Denmark therefore strongly encourages the Commission to present an improved EU climate policy architecture with a coherent set of policies that can deliver a 2040 target in a more cost-effective way, reflecting the following main elements:

- A uniform price signal across Member States and sectors to ensure the most cost-effective reduction effort.
- The polluter pays the costs of climate change, while those who contribute to removal of greenhouse gas from the atmosphere should be rewarded accordingly.
- A level playing field to reduce the risk of carbon leakage within the EU.
- Targeted support to vulnerable groups and businesses to address possible negative impacts of carbon pricing in a way that maintains incentives for a green transition.

The EU's climate efforts should be implemented within a framework of sustainable economic policy and sound public finances. EU-level funding should contribute in an effective and result-oriented way to achieve EU's climate goals.

To fulfil this purpose, Denmark suggests that a revised climate architecture could be designed based on three main pillars:

#### **1. Emissions Trading System – a uniform price signal across energy, industry and transport sectors**

The ETS has demonstrated its worth as the EU's main climate policy instrument. The ETS sets an effective carbon price, making it the most cost-effective instrument to deliver on

the 2040 EU climate target and to incentivise market-driven deployment of low-carbon technologies and phase-out of fossil fuels across the EU. It boosts green innovation and applies the polluter pays principle in practice. In addition, it provides revenue that can be used to support the green transition.

With the Fit for 55 revision, emission trading will be extended to cover approximately 80% of EU's total emissions. However, the division of the two ETS systems creates a barrier for a cost efficient reduction effort across sectors. Denmark therefore strongly encourages the Commission to merge the two ETS systems from 2030 at the latest to ensure a market-based, uniform carbon price, sufficient liquidity as well as lower total reduction costs. Consequently, the instruments introduced to limit the CO<sub>2</sub> allowance price in the new ETS for road transport and heating in buildings with the Fit for 55 revision should be omitted.

The Fit for 55 revision of the ETS means that the last allowances in the existing ETS will be issued by 2039 and in the new ETS for road transport and heating in buildings by 2044. If further emissions should be allowed from these sectors, there will be a need to consider new rules for issuing allowances. To create market-based incentives for delivering the EU's climate neutrality target, creation of additional allowances should be balanced by an equal amount of removals.

#### *Integrating negative emissions technologies in the ETS*

To reach the EU's objective of climate neutrality, a substantial amount of removals of CO<sub>2</sub> from the atmosphere is needed to counterbalance residual emissions. However, there are currently no economic incentives in the EU's climate regulation for scaling up and delivering negative emissions through technological solutions. The Commission should assess policy options for further incentivising the development and deployment of carbon removal technologies while retaining high ambition for conventional emission reductions. This could include integrating negative emissions technologies in the ETS – for example by allocating revenue to installations that generate negative emissions certified through robust and transparent carbon accounting. This should include a carbon management framework to ensure that the creation of new allowances is based on physical carbon removal, to prevent an increase of net emissions.

#### *Ambitious and effective EU climate and energy regulation fit for a decarbonised energy system*

Applying an effective carbon price will not in all aspects be sufficient to achieve the reductions needed. In such cases, an ambitious and cost effective enabling framework with coherent EU-wide policies and standards is required. This includes, for instance, strengthening product standards in the energy and transport sector.

At the same time, a fully decarbonised energy system towards 2040 requires that we rethink the existing EU regulatory set-up. We need to continue to ensure that the build-out of the considerable amounts of necessary renewables at the European level is cost-efficient and that sufficient infrastructure is available to create a flexible and integrated EU

energy market capable of storing and delivering the necessary amounts of renewable energy to European consumers and businesses. This should also provide the necessary economic incentives for Member States, which chooses to build out renewable energy with the main purpose of exporting renewable energy across borders in the EU. The Commission is therefore encouraged to evaluate and modernise the EU's energy regulation with the aim of ensuring a coherent approach with the right incentives to tackle these key challenges toward 2040. This should include an assessment of whether the EU's regulatory instruments, including the amount and nature of the existing national obligations and sectoral targets, are fit for this purpose.

## **2. Agricultural pillar with a common EU reduction target- incentives for effective, climate-friendly, and competitive agricultural production**

Total EU agricultural greenhouse gas emissions have been stable since 2005. In addition, efforts to reduce emissions from agriculture vary between Member States. National efforts to regulate emissions from agriculture that impose costs on producers, come with a significant risk of carbon leakage internally in the EU and higher costs than necessary. Agriculture will account for an increasing share of EU emissions as the rest of the EU economy decarbonises. The ETS for road transport and heating in buildings leaves agriculture as the largest emitting sector of greenhouse gas without effective EU level regulation.

Therefore, a new approach is needed. In Denmark, the government is aiming to present proposals for domestic pricing of agricultural greenhouse gas emissions to contribute to Denmark's 2030 climate commitments. We also need more cost-effective measures in the EU to ensure that the agricultural sector contributes to the EU's climate targets. Denmark therefore proposes a new, more targeted approach with an EU-wide reduction target combined with ambitious and effective EU-level regulation with emissions trading as the central instrument. This would create a level playing field, increase cost-effectiveness and would improve incentives for farmers to reduce emissions and increase removals of greenhouse gasses. It could drive innovation and cost reductions in mitigation technologies and promote efficient and climate and environmentally sustainable food production in the EU.

Denmark therefore strongly supports introducing emission trading for agriculture. An ETS for agricultural emissions would not only price greenhouse gas emissions in accordance with the polluter pays principle, it would also ensure that mitigation effort is being taken at the lowest marginal cost, to the benefit of both farmers and consumers.

The scope of the agriculture ETS should be as wide as feasible; in theory, the most cost-efficient approach would cover all on-farm emissions and removals. This includes emissions and removals taking place on agricultural soils reported in the LULUCF sector; an integration of agriculture-related LULUCF CO<sub>2</sub> fluxes with the methane and nitrous oxide emissions reported in agriculture would allow for a much more integrated policy framework. It could be considered to use revenue generated through emission trading to support a sustainable transition of the sector.

At the same time, Denmark acknowledges the possible practical challenges involved in establishing an all-encompassing greenhouse gas pricing scheme in the EU due to data limitations and concerns about administrative burdens and costs. The climate efforts in agriculture could therefore be supported by EU-wide sectoral regulation such as standards for fertilisers, feed and farm facilities. The Commission is therefore invited to analyse options for how the EU Common Agricultural Policy in the future could contribute to a larger extent to the EU's climate and environment efforts, for example by incentivising climate-friendly farm practices.

Common EU regulation would significantly level the playing field for European farmers. This would concurrently contribute to fulfilling three purposes:

1. Eliminate the unfair internal competition between farmers across Member States with differentiated reduction targets in the Effort Sharing Regulation;
2. Lower the costs of the green transition to society as a whole while ensuring efficient use of the Common Agricultural Policy; and
3. Reduce the risk of carbon leakage among Member States.

As is the case with all EU climate policy, an ETS for agriculture comes with a risk of carbon leakage to third countries. Denmark encourages the Commission to explore options for mitigating such a risk, including by possibly expanding the scope of the CBAM in full respect of WTO trade rules.

### **3. Separate sector for forestry with a common EU target for net removals.**

To reach climate neutrality and net negative emissions in the future, the EU should ensure a consistent, long-term and sustainable contribution from our forests. Regulating emissions and removals from forestland in a separate forestry sector would allow for a more focused approach and ensure an appropriate balance between short-term and long-term climate benefits. A similar approach to the agricultural sector as set out above should be explored, in which a common EU net removals target is implemented through EU level regulation rather than differentiated national targets for Member States. As for agriculture, such an approach would enable a level playing field.

Denmark supports looking into options for designing incentives for individual forest owners to increase long-term net removals of carbon from the atmosphere. The EU certification framework for carbon removals could turn out to be a valuable tool in this regard, for example by paving the way for efficient results-based payment schemes and by facilitating private finance for ecosystem services. Therefore, it is of high importance to ensure the implementation of a robust and trustworthy certification framework well before 2030.