



AUDIT
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REPUBLIC
OF CYPRUS

HAVE THE ACTIONS PROMOTED BY THE REPUBLIC OF CYPRUS ACHIEVED THE DESIRED RESULTS TO REDUCE GREENHOUSE GAS EMISSIONS?

Executive Summary



**AUDIT OFFICE OF THE REPUBLIC
SPECIAL REPORT no. ΠΕ/02/2023**

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AUDITED ENTITIES

Ministry of Agriculture, Rural Development and Environment

Department of Environment

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Our Office decided to carry out this audit, taking into account both the growing environmental awareness of the urge to reduce Greenhouse Gas (GHG) emissions, in order to combat climate change, which consists a challenge at global and European level, as well as the fact that, in recent years, there has been a significant increase in the proceeds of the Republic of Cyprus («the Republic») from the sale of emissions rights through the Emissions Trading System (ETS).

European Union (EU) 's and Cyprus', as a member state, actions to reduce GHG emissions, come under two main pillars, the ETS, which is applied to specific industry sectors (power plants, industry factories and aviation) and the effort sharing to reduce emissions of other sectors [domestic transport (excluding aviation), buildings, agriculture, small industry and waste].

Set up in 2005, the ETS, which promotes the economic, efficient and effective reduction of GHG emissions, operates under the cap-and-trade principle. Specifically, the overall volume of GHG that can be emitted by power plants, industry factories and aviation covered by the ETS is limited by a «cap» on the number of emission allowances. Within the «cap», entities receive or buy emission allowances, which they can trade as needed. The «cap» decreases every year, ensuring that total emissions decrease. The ETS is an effective tool in helping drive emissions reductions cost-effectively. Each allowance gives the holder the right to emit one tonne of carbon dioxide (CO₂.)

The member states auction their allowances under certain conditions, in accordance with the provisions of the Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and amending Council Directive 96/61/EC (ETS Directive).

At the end of each year, regulated entities must surrender enough allowances to cover all of their emissions. If a regulated entity reduces its emissions, it can keep the surplus allowances to cover its future needs or sell them to another entity that is short of allowances. Those who do not align their emissions with their allowances can choose either to take steps to reduce their emissions, buy the required additional allowances on the market, or a combination of the above two. The ETS covers more than 10.000 installations in the EU in the power generation and industry sectors, which are collectively responsible for 40% of the EU's total GHG emissions.

The Republic, initially, auctioned allowances in 2012 and during the period 2012 – 2020 (ETS phase 2) auctioned a total of 6.201.500 allowances, of which 5.621.500 and 580.000 related to stationary installations and aviation, respectively. The relevant total revenues, during the above period, amounted to €103.160.956. During the first two years of the period 2021 – 2030 (ETS phase 3), 1.478.000 and 1.293.500 allowances were auctioned, respectively, and the related revenues amounted to €78.415.320 and €102.888.405, respectively. As of the above, the revenues for 2022 are almost as much as the revenues for the entire period of phase 2 (2012 – 2020). This indicates the importance of the growing revenue and the urge for their proper management.

The actions of the second pillar concern effort sharing, which establishes binding annual GHG emission targets for member states to achieve climate neutrality by 2050, by implementing policies and measures for sectors not covered by the ETS. The aim was to reduce GHG emissions in the EU by 40% by 2030

(from 1990 levels). For Cyprus, the national binding target for 2030 was a 24% reduction, compared with 2005. As part of the «fit for 55» package, the Council of the EU adopted, on 25.4.2023, five laws which set the EU's policies in line with its commitment to reduce its net GHG emissions by at least 55% by 2030, compared to 1990 levels and to achieve climate neutrality in 2050. The laws will be signed by the Council and the European Parliament and published in the EU's Official Journal before entering into force. For Cyprus, the national binding target for 2030 is now increased to 32% as compared to 2005.

The competent Authority for climate change in Cyprus is the Minister of Agriculture, Rural Development and Environment. At the same time, other Ministries and Services, such as the Ministry of Energy, Commerce and Industry, the Ministry of Finance, the Ministry of Transport, Communications and Works and the Directorate General Growth, are responsible for implementing the policies and measures to achieve GHG emissions reduction targets, depending on the sector they concern.

The scope of the audit was to ascertain whether the actions promoted by the Republic, in recent years, have provided the desired results to reduce GHG emissions in the most economical, efficient and effective way.

The most important findings, emerged from the examination of the audit questions developed, are summarized below:

a. Has the reduction target, for the period 2013 – 2021, in greenhouse gas emissions, for the Republic, been achieved?

For the period 2013 – 2020, the Republic achieved the national target reduction, in accordance with the defined allowances of GHG emissions allocated to Cyprus. We observed that, although GHG emissions in Cyprus were below the allocated levels until 2016, in the years following excesses were noted, however, due to the flexibility provided by the legislation regarding the banking of surpluses over time and their utilization to cover excesses in subsequent years, the targets until 2020 have been achieved. We noted that, with regard to the effort sharing pillar for the year 2021, Cyprus exceeded its (non-ETS) allocations in GHG emissions and, during the period 2013-2021, showed a gradual increase in actual GHG emissions, in contrast to the average European level, which decreased significantly. This raises questions as to whether Cyprus' reduction target was achieved in the most efficient way.

We recommended the implementation of policies and actions designed to reverse the increasing trend of GHG emissions, in order to achieve the future reduction targets.

b. Did the implementation of the Electronic Trading System in Cyprus contribute to the reduction of GHG emissions?

In contrast to the significant reduction brought about by the ETS in EU-wide GHG emissions, the total emissions from stationary installations in Cyprus, for the period 2013 – 2021, decreased by only 15% compared to 2005 emissions, while the emissions from power production showed an increase of around 6%. This indicates that, at national level, the ETS has not been as effective as at EU-wide level.

Also, the Department of Environment (DE) monitors the quantities of allowances auctioned and their corresponding value. However, we observed that the monitoring method carries risks, since the spreadsheets used are not equipped to serve as a database to store and track such a large volume of

data, especially considering that, over time, this volume will increase exponentially. We also observed that the competent Authority, since 2016, did not comply with the provisions of the Greenhouse Gas Emission Allowance Trading System Law (L.110(I)/2011) regarding its obligation to provide the House of Representatives with relevant reporting and to ensure publicity on the matter.

We recommended that a database would be more appropriate to store and monitor ETS data, in order to protect data integrity. Also, we urged the competent Authority to provide timely and appropriate reporting to the House of Representatives, in accordance with the provisions of the legislation.

c. Does the Republic of Cyprus take sufficient measures to address the risk arising from the rolling down of the increased cost of the Electricity Authority of Cyprus (EAC) arising from emitting greenhouse gases to consumers?

The GHG emissions from stationary installations included in the ETS are generated mainly from the power production with conventional fuels, which accounts for approximately 70% of the total GHG emissions produced by all installations nation-wide.

Since 2013, power plants are not eligible for free allocation of ETS allowances. However, Cyprus was exempted from the general rule for the period 2013 – 2019. Therefore, the free allowances allocated to EAC were reduced each year, reaching zero in 2020.

We noted that, according to EAC's data, during the period 2017 – 10/2022, a total amount of €569.581.932 was spent for the purchase of GHG emissions allowances, through the ETS, which was rolled down to consumers.

We urged the competent Authority to take actions to address the rising cost of power production.

d. Were the auctioning revenues under the Emissions Trading System allocated in accordance with the provisions of the legislation?

The use of auctioning revenue generated under the ETS is regulated by the ETS Directive, which provides that all revenues generated from the auctioning of allowances in the aviation sector and at least half of the revenues generated from stationary installations should be used to tackle climate change, according to specific provisions. We observed that there are ambiguities in the national legislation, which harmonizes the national legal framework with the European one, regarding the use of revenue from the aviation sector.

We identified major weaknesses in the monitoring and control of the data, regarding the use of revenue, that the competent Authority submits to the European Commission. We also noted that, although the National Energy and Climate Plan (NECP) for the period 2021 – 2030 created the basis for a more rationalised use of the revenues from the auctioning of GHG emissions allowances, this was not implemented in practice, as these revenues were retrospectively linked to relevant projects or actions implemented through the annual State Budget.

We recommended a relevant amendment/harmonization of the institutional framework, to remove any ambiguities on the subject and to take all the necessary measures, by the competent Authority, for timely harmonization of the national institutional framework with the European one. Also, the role of

the AC should be redefined, in order to promote a proper and efficient revenue management, in accordance with the requirements of the legislation. Additionally, the competent Authority should find ways for an effective use of ETS revenues, by implementing an effective governance system, to ensure the implementation of the NECP.

e. Has the contribution of the implemented projects been evaluated based on the provisions of the legislation?

We observed that the competent Authority has not carried out any post project monitoring / evaluation to assess the contribution of the projects/actions implemented through the use of ETS revenues, in terms of their environmental, social or other impact, their contribution to the achievement of national targets, or against specific performance indicators.

We recommended that the competent Authority evaluates the performance of the projects implemented, in terms of their energy efficiency or their impact on the modernization of the energy system.

f. Is the agreement concluded between the Ministry of Agriculture, Rural Development and Environment (MARDE) and the Cyprus Stock Exchange (CSE), by which the Ministry appointed CSE as an auctioneer to auction ETS allowances on its behalf, in accordance with the relevant institutional framework?

The competent Authority appointed CSE, as the auctioneer. During the time period from 2013 – 2022, CSE received, for its services, an amount of €3.365.277.

We expressed the opinion that CSE agreement seems to be against the interests of the Republic, since the CSE's fees are determined based on the value and not the volume of allowance transactions, especially taking into account that, over time, there has been a noticeable increase in the value, without corresponding change in the volume. We also pointed out that, although CSE is moving ahead with its privatization plans, the competent Authority has not yet investigated other possible auctioneer options, either in Cyprus or abroad.

We recommended that the competent Authority investigate, firstly, if auctioning is possible to be undertaken by another body/organization, especially taking into account that, from 2024 onwards, the ETS will be extended to cover additional sectors, and, secondly, if such an agreement falls under public procurement legislation.

We also expressed the opinion that, even if the appointment of an auctioneer agreement does not fall under public procurement legislation, the competent Authority should aim to ensure that, during auctioneer selection process, the primary principles of transparency, equal treatment and non-discrimination that lie at the core of public procurement are respected, for public interest.

g. Are the actions taken by the Republic of Cyprus to achieve the effort sharing national targets for GHG emission reduction efficient and effective?

We observed a lack of an effective mechanism to monitor the implementation of policies and measures with a positive, measured and assessed impact.

We noted that, during the time period from 2013 – 2020, the Republic had an obligation to report to the European Commission only on policies, measures and forecasts. For the time period from 2021 – 2030, starting from 15.3.2023, the monitoring and reporting mechanism is based on the principles of NECP integration and the Republic has to report on the implementation of climate and energy policies.

We recommended the assessment of the policies and measures implemented to date, in order to assess their efficiency and make decisions on additional measures required, given the urge to achieve a further reduction, based on the recent European legislation amendment.

h. Have appropriate plans been made to deal with emissions coming from less elastic sectors of the economy?

The DE, supported by experts/consultants, prepared a study to evaluate the effectiveness of policies and measures to mitigate climate change and reduce GHG emissions until 2030. The measures mentioned in the aforesaid study were incorporated in the NECP.

Although, the Republic has to report to the European Commission every two years, starting from 15.3.2023, on the implementation of the aforesaid policies and measures, we observed that the first relevant report, which was submitted late in April 2023, was incomplete.