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Session 2: Energy independence costs – the financing of energy and climate measures

Czech Presidency of the Council of the European Union

Parliamentary Dimension

Introduction – Energy and Climate Transition

In 2019, the EU has enshrined an objective of achieving climate neutrality by 2050 in the European Green Deal (EGD). Subsequently, the goals of reducing greenhouse gas emissions by 55% by 2030 and achieving climate neutrality by 2050 were incorporated in the so-called Climate Law. The European Climate Law was finally adopted in June 2021. Specific plans to achieve these goals were presented in July 2021 as part of the Fit for 55 package.

The green transition involves considerable costs and will have significant social impacts, especially in some regions. The current energy crisis and the necessary transformation of the energy sector, related for example to a cut-off from the Russian Federation's fossil fuels, represent additional costs, mainly for countries more dependent on those sources.

Fit for 55 package

The package amends key EU climate legislation (emissions trading, energy taxation, support for renewables, support for energy efficiency, stricter standards for new cars) and introduces new mechanisms (a carbon tariff, the Social Climate Fund). The European Parliament and the Council must agree on the final form of the individual proposals in the package.

Architecture of the Fit for 55 package and main points of the Commission proposal

Financial instruments – pricing	Objectives	Standards – regulations
Stronger Emissions Trading System (ETS) – increase in linear reduction factor, one-off reduction in the overall emission cap, strengthening of market stability reserve; **phasing out of free allowances in aviation**	Revision of the Effort Sharing Regulation – 40% reduction target by 2030 (compared to 2005) – instead of 30%	**Stricter rules for passenger car and van emissions** – average zero emissions for newly registered vehicles by 2035 (and an interim reduction target of 55% and 50% by 2030 for passenger cars and vans)
Extension of the ETS to maritime transport **Introduction of a parallel system for road transport and buildings from 2025**	Revision of the LULUCF Regulation – carbon sequestration target of 310 million tonnes of CO_2 equivalent by 2030	Infrastructure for alternative fuels (electric charging every 60 km and hydrogen fuels every 150 km)
Revision of the Energy Taxation Directive (progressive inclusion of aviation fuel)	**40% renewable energy target** by 2030 – instead of 32% (targets for heating and cooling; addressing forest biomass)	ReFuelEU for aviation
New carbon offset mechanism at the border (carbon tariff) – fully applicable from 2026 on carbon-intensive products imported into the EU (cement, iron, steel, aluminium, fertilisers, electricity)	**New target for energy efficiency** (36–39%) plus an obligation for the public sector to renovate at least 3% of total floor area each year	ReFuelEU for maritime transport

Measures of support
A new Social Climate Fund (funding from revenues from a new emissions trading system for fuels in buildings and road transport, primarily to help citizens invest in energy efficiency, new heating and cooling systems and cleaner mobility on the basis of national plans)
Strengthening the Innovation and Modernisation Fund

Financing climate and energy measures

The EU's Multiannual Financial Framework (MFF) for 2021–2027, together with the *Next Generation EU* (NGEU) post-pandemic recovery plan, totalling over EUR 2 trillion in current prices (EUR 1 211 billion under the MFF and EUR 807 billion under the NGEU), devotes at least 30% of resources to climate-related spending. *National Recovery and Resilience Plans (RRPs)* should contribute to green transition and digital transformation, with at least 37% of the total financial allocation contributing to environmental objectives.

The NGEU is to be financed by joint borrowing by the Commission on behalf of the EU in the capital markets. The Commission is empowered to borrow up to EUR 806.9 billion (current prices) over the period 2021–2026. The debt is to be repaid by the Commission using new own resources.

Next generation of EU own resources

In December 2021, the Commission proposed introduction of new own resources. Negotiations on individual proposals are underway in the Council and the European Parliament.

1) **a resource based on the *EU Emission Trading System*** – 25% of the revenues from allowances auctioned under the EU ETS. The *Fit for 55* package also includes a revision of the EU ETS. Emissions from the maritime and aviation sectors are to be gradually included. Introduction of the EU ETS for buildings and road transport is also being discussed. The EU ETS is expected to contribute an average of EUR 9 billion per year to the EU budget over the period 2023-2030;
2) **a resource based on the *Carbon Border Adjustment Mechanism (CBAM)*** – 75% of the revenues from the sale of certificates under the Carbon Border Adjustment Mechanism. The mechanism targets carbon-intensive goods and aims to reflect in the price of imported goods a carbon price equivalent to the amount that would be paid if the goods were produced in the EU. It is estimated to bring an average of EUR 0.5 billion per year to the EU budget over the period 2023-2030;
3) **a resource of 15% of the share of the residual profits of the largest and most profitable multinational enterprises redistributed to Member States where the goods or services are used or consumed** – based on the OECD/G20 agreement ("Pillar I") on the reform of the international tax framework. This source could bring EUR 2.5–4 billion per year to the EU budget.

Just Transition Fund

The Just Transition Fund, established by Regulation (EU) 2021/1056, is part of the broader Sustainable Europe Investment Plan, which complements the just transition part of the InvestEU programme and the European Investment Bank's (EIB) Public Sector Loan Facility. The Fund is a key instrument to help regions most affected by the green transition, i.e. the transition to climate neutrality, and to mitigate its negative impacts.

The EUR 17.5 billion in resources of the Just Transition Fund comes from both the MFF 2021–2027 (EUR 7.5 billion) and the NGEU (EUR 10 billion). The disbursement of the Fund's resources is conditional on the preparation of a Just Transition Plan, which includes information on where the resources are to be used based on the estimated economic and social impacts of the green transition.

Social Climate Fund

The proposal to create a *Social Climate Fund (SCF)* aims to mitigate the social impacts of the transition to climate-neutral economy. The proposal specifically responds to the plan to introduce a new separate ETS for the buildings and road transport sectors. The Fund is to be used by Member States to mitigate the negative social impacts of the new ETS.

The Fund's resources are to be used as follows:

1) financing temporary direct income support for households placed at risk by the introduction of the new EU ETS;
2) support for emission-reducing measures and investments in the road transport and construction sectors.

Measures and investments can relate to reducing dependence on fossil fuels through, for example, renovating buildings and improving their energy efficiency; decarbonising heating and cooling in buildings; promoting low carbon and public transport, etc.

The Fund is to be established for the period 2025–2032. The total financial envelope of the Fund is proposed at EUR 72.2 billion (in current prices), of which EUR 23.7 billion is intended for 2025–2027 and EUR 48.5 billion for 2028–2032. 25% of the Fund's resources is to be financed by revenues from emissions trading for the buildings and road transport sectors. The European Parliament and the Council must agree on the final proposal.

Revision of the Energy Taxation Directive

The "Fit for 55" package includes a revision of the *Energy Taxation Directive (ETD)*. The draft amendment was presented by the European Commission in July 2021 and its form is currently being discussed in the EU Council. The aim of the revision is to ensure that the taxation of various energy products (fuels, heating fuels or electricity) is proportionate to their environmental impact.

The proposal introduces a new tax rate structure based on the energy content of fuels and electricity and their environmental impact, broadens the tax base and adjusts minimum rates, which are to be updated annually based on inflation. Furthermore, some exemptions will be phased out and taxation of aviation fuel and heavy oil in the maritime industry will be introduced.

Rising prices on energy markets

Energy prices started to increase slightly in the first quarter of 2021, rising at a faster pace in the second half of the year. The rise in energy prices was mainly driven by the COVID-19 crisis and a surge in consumption associated with the economic recovery. Following the outbreak of war in Ukraine, the uncertainty surrounding gas and oil supplies has further fuelled the rise of energy prices.

Therefore, in October 2021, the European Commission issued a Communication entitled Tackling rising energy prices: A toolbox for action and support, in which it points out that the price increase comes in a period of economic recovery after the coronavirus crisis and that it may lead to weaker support for the energy transition. In the Communication, the Commission calls for swift coordinated action and points to the possibilities for targeted measures available to the Member States under the existing EU legal framework.

Subsequently, in March 2022, the Commission presented another Communication: Security of supply and affordable energy prices: Options for immediate measures and preparing for next winter. The Communication summarises the advantages and disadvantages of specific exceptional short-term options to mitigate energy price increases. It also proposes common European measures to address the root causes of the gas market issues to secure supplies at reasonable prices for next winter and beyond. Amendment of Regulation 2017/1938 concerning measures to safeguard the security of gas supply was also approved, introducing, for example, an obligation to fill gas storage facilities to at least 90% of capacity (80% for 2022).

Joint gas purchasing

In April 2022, the EU Energy Platform was established to support joint gas purchasing through aggregation and structuring of demand, optimised and transparent use of infrastructure and international outreach activities. The platform is a voluntary coordination mechanism. Regional units were also established: On 5 May 2022, the Commission and Bulgaria set up the first regional unit under the EU Energy Purchasing Platform, coordinated with neighbouring countries in South-East Europe. In June, another regional unit was initiated – for Central and Eastern Europe, linking the cooperation of the EU countries of Central and Eastern Europe with Ukraine and Moldova. The actual purchasing mechanism has not yet been introduced. However, it is part of the REPowerEU plan.

Windfall tax

A windfall tax could be one way to finance measures to reduce the negative impact of rising energy prices. This is not a new concept; a similar tax has historically been introduced in the UK or the US, for example in the banking or oil sectors. The windfall tax is applied to companies that generate a significant increase in their income as a result of circumstances or events for which they are not responsible. It is generally considered that windfall profits constitute excessive, undeserved or unfair profits. Excess profits must be visibly linked to an external cause, not to innovation, mechanisation or investment in the company. The tax is usually imposed for a limited period of time. Windfall profits tend to be associated with price volatile sectors.

In March 2022, as part of the REPowerEU plan, the Commission invited Member States to consider imposing temporary *windfall tax* measures on electricity producers. The introduction of this tax could be used by states to finance temporary emergency measures to combat high energy prices.

The new REPowerEU

The Communication from March 2022 entitled REPowerEU: Joint European action for more affordable, secure and sustainable energy sets out measures to end the EU's dependence on fossil fuel supplies from the Russian Federation before 2030. Subsequently, on 10 and 11 March 2022, EU leaders adopted the so-called Versailles Declaration on Russian aggression against Ukraine, as well as on the issue of improving defence capabilities, reducing energy dependence and building a stronger economic base. EU leaders agreed, among other things, to accelerate the reduction of overall dependence on fossil fuels, taking into account national circumstances. They also invited the Commission to present a plan to ensure security of supply and affordable energy prices during the next winter season.

In May, the Commission presented the REPowerEU plan containing a series of measures to ensure a rapid reduction of the EU's dependence on Russian fossil fuels. This is to be achieved through **energy savings, diversification of energy supply, rapid replacement of fossil fuels by accelerating Europe's transition to clean energy**. These three measures are to be supported by a smart combination of investment and reforms that will link the REPowerEU and the Next Generation EU post-pandemic recovery plan.

Energy savings are the quickest and cheapest means of solving the current energy crisis. For example, the Commission proposes to increase the Union's energy efficiency target. Member States should collectively ensure at least a 13% reduction of energy consumption in 2030 compared to 2020 projections. As part of the **clean energy transition**, the Commission also proposes to increase the Renewable Energy Directive's target to 45% by 2030, up from the 40% specified in last year's proposal. The Commission supports increasing the capacity of solar panels or expanding heat pumps. Accelerating the development of hydrogen infrastructure or boosting biomethane production should also help.

The Recovery and Resilience Facility (RRF) is to receive an additional EUR 20 billion (in grants) for REPowerEU-related objectives. These additional resources can be used by Member States after they update their National Recovery and Resilience Plans and supplement them with REPowerEU chapters. The Commission also proposes to allow Member States to transfer part of the Structural Funds allocation to the RRF for the REPowerEU objectives.

Topics for discussion:

Do we need to rethink the EU's climate targets set by the European Green Deal?

How to finance the climate and energy transition? Are the existing and newly proposed instruments sufficient?

How can we eliminate the negative social impacts of green transition? Is the Social Climate Fund a sufficient solution?

How to further combat rising energy prices? What is your experience with the implementation of measures at national level?

How to further improve energy security by diversifying the EU's energy supply? Are joint European purchases of energy a solution?

Is the REPowerEU plan sufficient? Which of its parts need to be emphasised or changed? Should we add new objectives?

What other challenges and issues related to the energy and climate transition are not yet being addressed at EU level even though they should be?

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