ETS reform: Making sensible use of the "Modernisation" Fund

Briefing by Energy Cities, March 2016

EXECUTIVE SUMMARY

Through a funding instrument known as the "Modernisation Fund", 2% of the EU Emissions Trading System (ETS) allowances will support 10 lower income Member States in Central and Eastern Europe in "meeting the high investment needs relating to energy efficiency and the modernisation of their energy systems" between 2021 and 2030. This timeframe, and the four years that will precede it, will be crucial to lay the foundations of a future-proof and resilient energy system. On the road from Paris, Energy Cities shares its vision on how the creation of a truly "modern" energy system can be supported via this fund, if the EU is serious about its goal to become virtually carbon-free by 2050.

As a pillar of the EU climate policy and the largest system of its kind, a properly-functioning ETS should be faithful to the Europe's democratic model. The ETS Modernisation Fund should rely on the five following cornerstones, detailed hereafter:

1. Go local: the future of the energy system is decentralised!
2. Support employment-intensive projects
3. Invite the right people to sit at the governance table
4. Divest carbon trading revenues to the local energy transition
5. Make it an open and transparent process

1 GO LOCAL: THE FUTURE OF THE ENERGY SYSTEM IS DECENTRALISED!

The Modernisation Fund will generate approximately €8 billion for the 10 eligible Member States Poland, Czech Republic, Romania, Hungary, Slovakia, Bulgaria, Croatia, Estonia, Lithuania and Latvia.
The modern energy system that drives the transition to a low-carbon, resilient energy economy is integrated and decentralised. It is grounded in strong local energy and climate action, which take the form of e.g. Sustainable Energy Action Plans (SEAP) as in the Covenant of Mayors for Climate & Energy or the Polish low-carbon economy plans of local authorities.
In the Covenant of Mayors for Climate & Energy, over 200 local authorities from Central and Eastern Europe have established a SEAP with clearly defined energy efficiency and renewable energy measures for the coming decades. Similarly, in countries like Poland or Hungary, hundreds of local authorities are setting up local plans to take climate action, proving to be more ambitious than their national governments.

Many local authorities' climate and energy action plans have a clear, long-term vision for the energy future of their territories, with a mid-term objective by 2030 and a long-term goal by 2050. These visions need to be implemented through clear investment roadmaps, which are shared and designed by local stakeholders.

In order to fulfil the goal of a locally driven energy transition in Central and Eastern Europe, investment roadmaps for the next 15 to 35 years have to be drawn up, just as it was done in Bistrița.

The period of 2017-2020 will be crucial in planning the investments to catalyse this transformation, in order to stay on the trajectory of the Paris agreement. Therefore, the Modernization Fund should finance local processes in the eligible Member States, which are already clearly defined in local authorities' climate and energy investment plans. The Modernization Fund should ensure the funding of long-term, sustainable local actions, such as the energy efficient refurbishment of buildings, the development of clean district heating and cooling systems, the installation of renewable energy production sites like solar panels on roofs or small-scale wind turbines, etc.

ENERGY VISION 2050 IN BISTRIȚA, ROMANIA

The Romanian municipality Bistrița has created in 2014 in the framework of the European IMAGINE project a collaborative, inclusive strategy to ensure a sustainable energy future.
Bistrița's vision involves a clear 3-phase framework that puts the municipality on track to cover half of its energy needs from renewable sources and make the energy mix of its buildings 100% renewable by 2050. The municipality will tap into its local, sustainable biomass potential and boost solar and wind production to achieve these goals.
In addition to this, Bistrița developed a roadmap titled "The Annual Energy Book", which lists all its measures planned until 2050. Bistrița's roadmap focuses on 8 different fields, which are energy supply, buildings and facilities, infrastructure, employment, mobility, urban development, public procurement and instruments. The "Annual Energy Book" is being reviewed, updated and approved every five years by the city council, in close collaboration with citizens and other local stakeholders.
The IMAGINE project was financed by the EU INTERREG programme.

2 SUPPORT EMPLOYMENT-INTENSIVE PROJECTS

THIRD INDUSTRIAL REVOLUTION IN FRENCH REGION NORD PAS-DE-CALAIS PICARDIE

The Third Industrial Revolution plan of Nord Pas-de-Calais Picardie aims at making the French region fit for the modern, decentralized energy system. Its strategy is based on 5 pillars: investing in small-scale renewables, energy efficiency, energy storage, smart grid and sustainable transport. By 2050, Nord Pas-de-Calais Picardie will reduce its energy use by 60% and create 150,000 jobs, which are more than the current Polish coal sector employs.
In order to finance its Third Industrial Revolution, Nord Pas-de-Calais Picardie will employ different innovative financial instruments. The sustainable energy utility for instance is governed by the communities it serves and can aggregate and leverage funds through third-party financing, government incentives, peer-to-peer lending, bonds, etc. This instrument is tailored e.g. to finance the retrofitting of buildings and offices and can ensure mutual benefits for the public and private sector. The region will also use social currencies and cooperative finance to involve citizens and ensure that direct financial benefits of energy projects stay within their communities.

The shift to a low-carbon, resilient economy will open up new opportunities to the eligible 10 Member States of the Modernisation Fund. Using the Modernization Fund to support employment-intensive industry sectors such as energy efficiency and renewables can drive the creation of local, non-outsourceable jobs in Central and Eastern Europe and give an economic boost to the region.
A 2014 study by the UK Energy Research Centre shows that investments in new renewable energy and energy efficiency projects create on average 10 times more jobs than similar-sized fossil fuel ones.

3 INVITE THE RIGHT PEOPLE TO SIT AT THE GOVERNANCE TABLE

The governance of the Modernisation Fund should be ensured by local, regional and national financial institutions in the eligible Member States instead of the supranational European Commission and EIB. These institutions, such as the National Fund for Environmental Protection and Water Management in Poland, should select suitable projects for Modernisation Fund financing based on the investment planning in each region. These bodies know the local requirements best and can widely reach out to and support local authorities through different tools in their climate and energy action, such as by helping local authorities develop energy planning.

POLISH NATIONAL FUND FOR ENVIRONMENTAL PROTECTION AND WATER MANAGEMENT

The Polish National Fund for Environmental Protection and Water Management (Polish National Fund) is a key example of how a successful, locally inclusive governance of the Modernization Fund can be ensured. Since 1989, the Polish National Fund has supported Polish local authorities with financing, capacity-building (energy planning e.g.) and training. Moreover, the fund consults local authorities through discussion forums or exchange platforms in the design of its programme offers. Through its strong local anchorage, the Polish National Fund can best address the energy needs at the local level. Through programs such as SOWA (€50 million budget), the Fund played a major role in the proliferation of public lighting modernization in Polish cities.
The Polish National Fund initiated the idea of local low carbon-economy plans in 2013 in Poland, inspired by the SEAPs from the Covenant of Mayors for Climate & Energy. The Fund is national coordinator of the Covenant of Mayors in Poland and has proven its crucial role in the multi-level governance framework of the initative, by e.g. enabling signatories to access the necessary means to develop their SEAPs.

BIELSKO-BIAŁA SHOWS THAT LOW-CARBON IS POSSIBLE IN POLAND

The modern energy system moves beyond huge, expensive gas pipelines and is based on low-carbon, self-sufficient local energy economies. The city of Bielsko-Biała is one of over 800 Polish local authorities that believes in this future for its territory. Although there is no legal obligation in Poland to develop a low-carbon economy plan, Bielsko-Biała and its citizens have voluntarily committed in August 2015 to implement such a plan, in order to establish a long-term better quality of life for the city.
Low-carbon economy plans such as in Bielsko-Biała include exactly those measures that the Modernisation Fund can help uplift: modernisation of the district heating and cooling system, thermal energy efficiency improvement in buildings, investing in generation of small-scale local renewables, encouraging citizens to switch to more energy-efficient consumption patterns, etc. It is the local level as in Poland that will drive the transition to a modern energy system. By taking a „think local first" approach, the Modernisation Fund can speed up this development for the benefit of citizens, consumers and local businesses.

National, regional and local financial institutions such as the Polish National Fund should be assisted in their decision-making by civil society organisations, in order to ensure that citizens have a say in directing investments from the Modernisation Fund to improve the quality of life at the local level. Drawing upon local action plans and investment roadmaps, the governing structures in the eligible Member States can best assess how the implementation of selected projects contributes to achieving the EU's 2050 goal of full decarbonisation.

Finally, there should be no limitation in the Modernisation Fund to fund small-scale projects on the local level. In the future energy system, which will rely more on demand management and the involvement of a myriad of different players and resources, the lion's share of investments must happen at the local level.
As for instance the example in the Western European city of Frankfurt shows, whose climate strategy to become 100% renewable by 2050 is based on 25% local RES, 50% energy efficiency and 25% of RES from external sources, 3 out of every 4 Euros spent to catalyse the clean energy transition have to occur locally.
Becoming 100% renewable is a goal that is also achievable for Central and Eastern European cities. The Lithuanian city of Kaunas is already half-way through to this goal on its territory, according to energy figures reported in its Covenant of Mayors SEAP from 2013. By using available local renewable sources such as hydropower and biogas from wastewater, Kaunas achieved this goal already years earlier than Lithuania itself.

4 DIVEST CARBON TRADING REVENUES TO THE LOCAL ENERGY TRANSITION

The price on carbon covers many heavy carbon industries (such as steel industry e.g.), which take a heavy impact on the livelihood of citizens in towns and cities in terms of e.g. air quality, noise or environment. Providing the revenue from carbon taxes in any form to finance measures of local and regional authorities is an absolute necessity to ensure a solidary, fair and just transition through the European ETS.

REGIONAL GREENHOUSE GAS INITIATIVE IN THE US

In the North-East of the US, a regional ETS has been operational since 2005. This ETS involves 9 states, which are Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island and Vermont. Their Regional Greenhouse Gas Initiative (RGGI) is the first market-based regulatory program in the US to reduce GHG emissions.
The RGGI has demonstrated how redirecting carbon revenues from allowance auctions into local energy efficiency and renewables can result in multiple benefits. In 2013 for instance, $1 billion (€900 million) in carbon revenues from the RGGI was provided for investments in energy efficiency, renewables, support to low-income families to pay for their energy bills or GHG abatement. This has resulted in $2.9 billion (€2.62 billion) lifetime energy savings for 3.7 million participating households and 17,800 businesses. Moreover, 3,700 workers received training in fields such as home retrofits. In Rhode Island for instance, RGGI revenues enabled 67 community and non-profit buildings to receive comprehensive efficiency upgrades.

CARBON CREDITS PAY FOR NEW BIKE LANES AND METRO STATIONS IN BUCHAREST, ROMANIA

Romania is a key European example of how revenue from EU ETS auctions can benefit the daily life of citizens and consumers. The Romanian government spends around 70% of the income it receives from the ETS on climate action projects. Between 2013-2014, this amounted to a staggering €260 million Euros. In the next 4 years, Romania expects to collect up to €2 billion from the EU ETS to lay the path towards a low-carbon and resilient economy.
One example of where ETS revenue is redirected to the local level in Romania is in Bucharest. Carbon credits have helped Bucharest pay for new bike lanes and metro stations. Now, the Romanian capital is home to 122 km of cycling paths and 4 metro lines with 45 stations. This number is bound to increase, as Bucharest wants to encourage its citizens to shift to clean transportation modes. Nowadays, only 1% of people in Bucharest use bikes and about 16% use the metro system.

Citizens have a right to know that the revenue from carbon taxes or the ETS is invested in areas that improve their quality of life, such as the renovation of old, inefficient buildings, the provision of clean and affordable energy to their homes or the creation of new transport infrastructure. Using this revenue to finance the local energy transition not only reduces the social impact of the ETS on European citizens, but more importantly increases their acceptance for a just energy transition.

5 MAKE IT AN OPEN AND TRANSPARENT PROCESS

All information should be publicly available (with an official English translation) on a dedicated website, including the applications, decisions, project documentation and monitoring reports of the governing structures in the eligible 10 Member States. The development of the investment policy and the adoption of project selection criteria shall undergo a consultation with relevant stakeholders.
An annual report on results of the MF should be presented to the European Parliament.

IN LIGHT OF THIS, ENERGY CITIES RECOMMENDS TO AMEND THE ETS PROPOSAL AS FOLLOWS:

Article 10d
Modernisation Fund

1. *A fund to support investments in modernising energy systems and improving energy efficiency in Member States with a GDP per capita below 60% of the Union average in 2013 shall be established for the period 2021-30 and financed as set out in Article 10. The investments supported shall be consistent with the aims of this Directive and the European Fund for Strategic Investments.*

> **Amendment to 1.:**
> The fund shall strengthen capacity-building of local and regional authorities in the design of cost-effective and bankable decentralized energy projects, in collaboration with all local stakeholders and civil society actors. The investments supported shall be consistent with bringing the European Union on a pathway to a fully decarbonized, efficient and resilient society by 2050.
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> **Justification for amendment:**
> The modern energy system is integrated, decentralised and grounded in strong local energy and climate action, such as in the framework of the Covenant of Mayors for Climate & Energy. Local authorities are developing a clear, long-term vision for low-carbon, resilient and energy-efficient territories, with clearly defined measures and actions laid out in local action plans and investment roadmaps. These efforts need to be supported by the Modernization Fund, in order to bring the EU on the trajectory of the global climate Paris agreement.

2. *The fund shall also finance small-scale investment projects in the modernisation of energy systems and energy efficiency. To this end, the investment board shall develop guidelines and investment selection criteria specific to such projects.*

> **Amendment to 2.:**
> Delete 2.
>
> **Justification for amendment:**
> There should be no limitation to fund small-scale projects on the local level, as the future modern energy system is decentralized, grounded in strong action and driven by local investments.

4. *The fund shall be governed by an investment board and a management committee, which shall be composed of representatives from the beneficiary Member States, the Commission, the EIB and three representatives elected by the other Member States for a period of 5 years. The investment board shall be responsible to determine a Union-level investment policy, appropriate financing instruments and investment selection criteria. The management committee shall be responsible for the day-to-day management of the fund. The investment board shall elect a representative from the Commission as chairman. The investment board shall strive to take decisions by consensus. If the investment board is not able to decide by consensus within a deadline set by the chairman, the investment board shall take a decision by simple majority.*
The management committee shall be composed of representatives appointed by the investment board. Decisions of the management committee shall be taken by simple majority. If the EIB recommends not financing an investment and provides reasons for this recommendation, a decision shall only be adopted if a majority of two-thirds of all members vote in favour. The Member State in which the investment will take place and the EIB shall not be entitled to cast a vote in this case. For small projects funded through loans provided by a national promotional bank or through grants contributing to the implementation of a national programme serving specific objectives in line with the objectives of the Modernisation Fund, provided that not more than 10% of the Member States' share set out in Annex IIb is used under the programme, the two preceding sentences shall not apply.

Amendment to 4.:
The fund shall be governed jointly by national, regional and local financial institutions in the beneficiary Member States. Drawing upon local action plans and investment roadmaps, the governing structures in the beneficiary Member States can best assess how the implementation of selected investment projects contributes to bringing the European Union on a pathway to a fully decarbonized, efficient and resilient society by 2050. Local and regional authorities and civil society actors shall assist the governing structures in the beneficiary Member States in selecting these investment projects supported by the Fund, in line with the requirements set forth in Paragraph 1 and 2 of this article. The beneficiary Member States shall consult local and regional authorities and civil society actors prior to setting up their respective governing structures for the Fund.

Justification for amendment:
National, regional and local financial institutions, such as the National Fund for Environmental Protection and Water Management in Poland, know best the local requirements and investment needs and can therefore ensure the most effective, decentralized governance of the Modernization Fund.

5. *The beneficiary Member States shall report annually to the management committee on investments financed by the fund. The report shall be made public and include:*
(a) information on the investments financed per beneficiary Member State;
(b) an assessment of the added value in terms of energy efficiency or modernisation of the energy system achieved through the investment;

Amendment to 5.:
(c) an assessment of the added value on the local and regional level achieved through the investments;

Justification for amendment:
Since the lion's share of investments will happen on the local and regional level, it is important to include a specific indicator in this regard to monitor the impact of the Modernization Fund financing on the ground.

6. *Each year, the management committee shall report to the Commission on experience with the evaluation and selection of investments. The Commission shall review the basis on which projects are selected by 31 December 2024 and, where appropriate, make proposals to the management committee.*

Amendment to 6.:
The Commission shall review the basis on which projects are selected by 31 December 2024 and, where appropriate, make proposals to the beneficiary Member States.

Justification for amendment:
The EU Commission is the most suitable body to fulfill this task, as it can provide valuable proposals to the beneficiary Member States, in order for them to make effective use of the Modernization Fund.

This briefing is supported by

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Healthy Cities, Towns, Regions Czech Republic

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Energy Cities : The European association of local authorities in energy transition

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We have more than 1,000 towns and cities members in 30 countries. Energy Cities leads the Covenant of Mayors' Office (www.eumayors.eu) and coordinate EU projects to capitalize on cities pioneers and give inspiration to more territories based on our 36 proposals for local energy transition. Visit our best practices website and read our blog and positions papers.

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