Modernisation Fund – catalysing the clean energy transformation in central and eastern Europe

APRIL 2016

The „Modernisation Fund“ will be established by amending „Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments“ (ETS revision post-2020). Within the framework of the EU's 2030 climate and energy policies, the fund aims to support lower-income Member States in meeting their investment needs related to energy efficiency, including financing small-scale investments projects and the modernisation of energy systems.

Between 2021 and 2030, two per cent of the allowances (approx. 310 million in total) will be set aside to establish the fund. The Commission estimates their sale will generate approximately EUR 8 billion. All Member States will contribute to the fund, which will benefit the ten Member States whose GDP per capita is less than 60 per cent of the 2013 EU average. These countries include: Poland – 43.41%, Czech Republic – 15.59%, Romania – 11.98%, Hungary – 7.12%, Slovakia – 6.13%, Bulgaria – 5.84%, Croatia – 3.14%, Estonia – 2.78%, Lithuania – 2.57%, Latvia – 1.44%

The fund should build on the experience of cooperation between the Commission and the European Investment Bank (EIB) and draw on features of the European Fund for Strategic Investments (EFSI), so that investments are consistent with the aims of the Directive and the EFSI. An investment board will be devised to develop guidelines and investment selection criteria for specific projects.

It is important to note that beneficiary countries might continue to receive substantial financial resources from the European Structural and Investment Funds (ESIF) for investments in renewables, energy efficiency and SMART electricity distribution and management projects as well (see Annex I).

Given our experience[1] with funding mechanisms at the EIB, Commission and EU budget, we recommend the following structural elements for the establishment of the Modernisation Fund.

STRATEGIC ALIGNMENT

- The Modernisation fund should be led by an investment policy which is aiming at the energy system transformation of the beneficiary countries with the objective to phase-out fossil fuels, achieve substantial energy savings and to build its energy generation on sustainable renewables.
- Member States eligible for support from the fund should be required to adopt binding energy system transformation strategies and national investment plans for 2050 that outline their contribution in reaching the EU's objective of 95 per cent emissions reductions by the middle of this century. The strategies would have to be approved by the Commission before the first funding could be granted to selected projects.

[1] http://bankwatch.org/enfants-terribles, http://www.counter-balance.org/wp-content/uploads/2016/01/EFSI-Briefing_for-EIB-Board.pdf

- Integrating the „energy efficiency first“ principle means that new energy production installations and the modernisation of old ones should be based on – and stress-tested against – long-term energy demand scenarios. Every country or region would have to prove that all energy efficiency options have been realised and that new capacities are only installed after taking into account the embedded energy reduction pathways.

- A pre-condition for the eligibility of a proposed measure is its proven consistency with the above-mentioned national 2050 clean energy roadmaps.

SCOPE OF SUPPORT

- The fund should prioritize investments into sustainable renewable energy, energy efficiency and energy saving technologies, „smart grid“ development, storage infrastructure enabling the further uptake of renewable energy, the housing sector (building renovation including refurbishment of residential and public buildings and heating and cooling modernisation), decentralised power and heat production and integrated urban sustainable energy development projects.

- Any support for eligible installations should be subject to the Emissions Performance Standard (EPS) in line with the EIB's rules and procedures.

- Direct and indirect support for unsustainable types of energy production, including all forms of nuclear power, retrofitting coal-fired power plants and co-firing with biomass, should be ruled out.

- Any measure has to be conditioned on strong safeguards to ensure the long-term sustainability of all projects, which are then operationalised by selection criteria.

- The fund should particularly support small-scale investment projects, bundling energy efficiency, decentralised renewable energy solutions and community-driven integrated approaches, in particular local sustainable energy action plans developed by local and regional authorities. For this purpose appropriate financing mechanisms should be made accessible (see Annex II).

- Sustainability and transparency requirements should apply also to intermediaries financing small-scale projects.

- CCS technology should not be considered eligible under the fund. The economic costs per unit of CO_2 stored, the long-term viability of CO_2 storage, the loss of efficiency (roughly 10-40 per cent) due to CCS installation and related higher energy consumption, and the commercial readiness of the technology, which will not be ready before 2020, disqualify CCS from public financing. In addition, it distracts attention from small-scale, truly sustainable and decentralised energy measures, and it risks crowding out finance for win-win solutions.

GOVERNANCE

- The governing bodies should include representatives from beneficiary countries' partnership structures, such as managing and environmental authorities, local and regional authorities and civil society organisations.

- The European Commission should develop and adopt project selection criteria, approve the countries project pipeline and monitor performance.

- Beneficiary Member States should put forward a pipeline of projects that meets the eligibility criteria. Countries should demonstrate when submitting projects how their implementation best contributes, in comparison to non-pre-selected projects, to achieving the EU’s 2050 goals.
- The EIB should play the role, along with national promotional banks, of financier. There is no need for it to be part of the investment board and management committee.
- There is no need to create another administrative structure. The fund can be implemented via the existing Cohesion Policy implementation bodies; i.e. approval of investment plans and eligibility of measures by the European Commission (DG Regio); and implementation of measures with national and regional managing authorities.
- All information should be publicly available (with an official English translation) on a dedicated website, including Member States‘ applications, decisions, project documentation and monitoring reports.
- Development of the investment policy and the adoption of project selection criteria should be consulted with stakeholders.
- The annual report on results of the fund’s implementation should be presented to the European Parliament.

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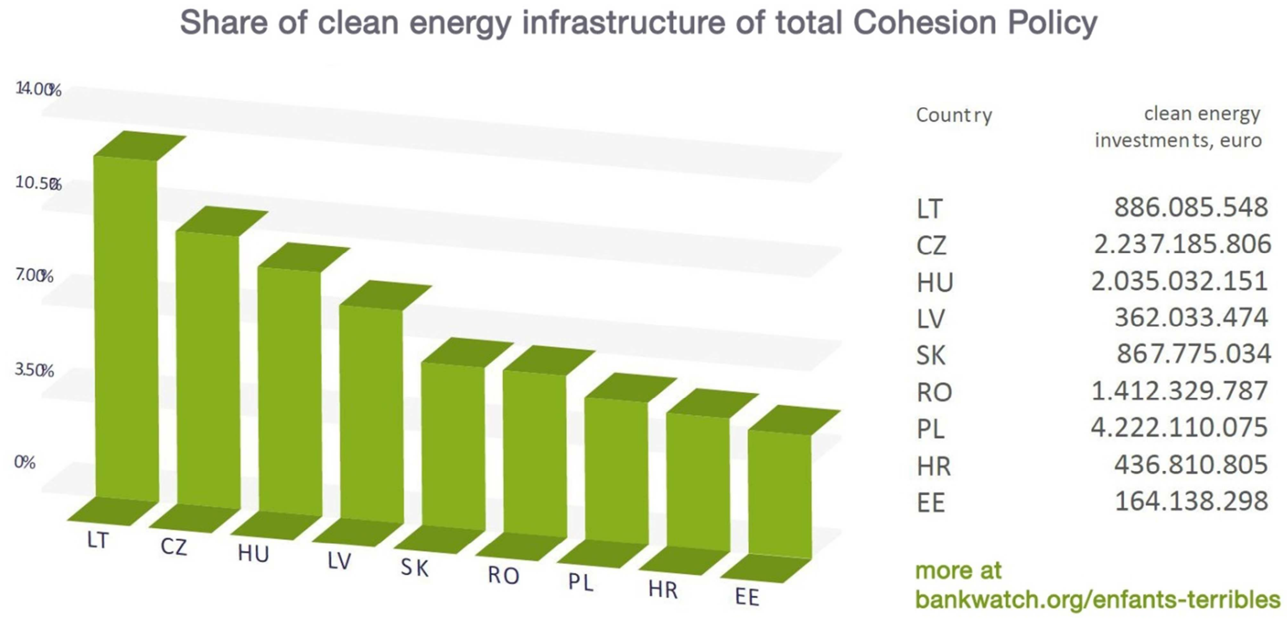
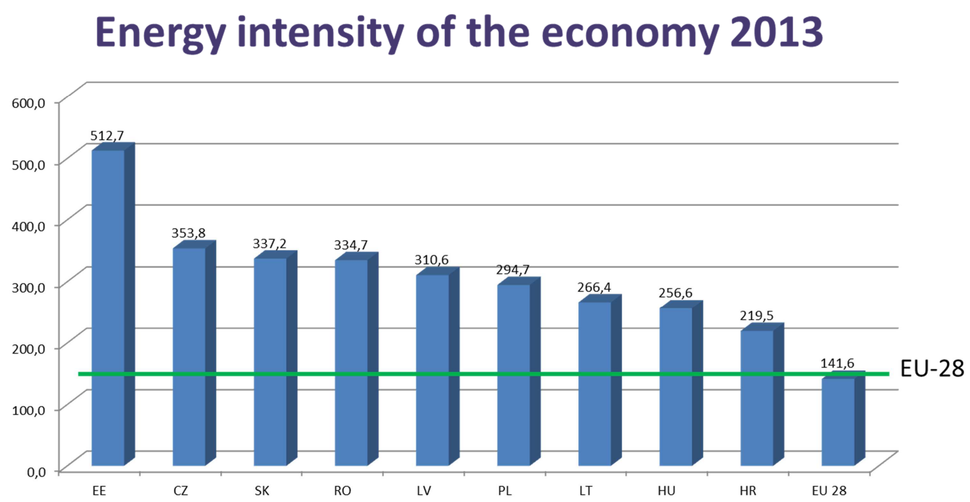
ANNEX I: Clean energy financing in central and eastern Europe from European Structural and Investment Funds



Support for energy efficiency, renewable energy sources and smart electricity distribution, Cohesion Policy 2014 -2020

Investments into clean energy infrastructure such as energy efficiency, renewable energy, smart distribution electricity grids and electricity storage will receive little more than one third of all climate action funding, around EUR 12.6 billion or 7 per cent of all Cohesion Policy funding for 2014-2020.

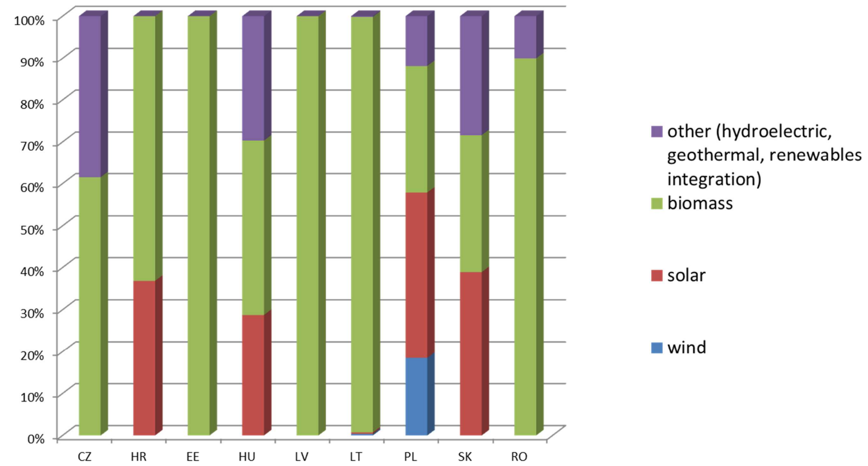
The lack of investments by CEE governments for climate action is particularly worrisome, given how energy intense and inefficient the economies of the region are, especially in relation to the rest of the EU. (see below: Energy intensity of the economy 2013 - Gross inland consumption of energy divided by GDP (kg of oil equivalent per 1 000 EUR), CEE and EU 28 average)



Energy intensity of the economy 2013 - Gross inland consumption of energy divided by GDP (kg of oil equivalent per 1 000 EUR), CEE and EU 28 average; Eurostat

Examining the support for renewable energy sources reveals some worrying details. The majority of this support is planned for biomass. And even support for coal and gas through the back-door is included.

Shares and types of renewable energy



Split of renewable energy sources; own calculations based on approved Operational Programmes according to categories of intervention

EU Cohesion Policy funding for RES, 2014 -2020

ANNEX II: **Modernisation Fund should help implement local sustainable energy action plans**

The ETS Modernisation Fund should finance the energy transition at the local level in central and eastern Europe. Specifically, the Modernisation Fund should finance the implementation of Sustainable Energy Action Plans (SEAPs) of Covenant of Mayors signatories in the ten eligible Member States.

Currently, these ten Member States are home to a total of 234 signatories of the Covenant of Mayors who have already submitted a SEAP. The Covenant of Mayors is a successful initiative in which local and regional authorities voluntarily commit to go beyond the EU's climate and energy goals.

As of February 2016, the distribution of Covenant of Mayors signatories having submitted a SEAP in the ten target countries of the Modernisation Fund is as follows:

- **Bulgaria:** 23 signatories
- **Croatia:** 59 signatories
- **Czech Republic:** 5 signatories
- **Estonia:** 3 signatories
- **Hungary:** 26 signatories
- **Latvia:** 19 signatories
- **Lithuania:** 14 signatories
- **Poland:** 33 signatories
- **Romania:** 48 signatories
- **Slovakia:** 4 signatories

These 234 local and regional authorities in Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia want to deliver ambitious energy and climate action with their SEAPs, but face barriers to fully implementing their SEAPs.

More than half of Covenant of Mayors signatories lack access to necessary finance

In particular, 58 per cent of these Covenant of Mayors signatories lack access to the necessary funds to finance their SEAP measures, as outlined in a mid-term evaluation report of the Covenant of Mayors in 2013. The Modernisation Fund can address this barrier by providing these engaged local and regional authorities with the necessary finance to implement their ambitious climate action for the benefit of European citizens.

Not only should the Modernisation Fund help these Covenant of Mayors signatories in central and eastern Europe finance their SEAP measures, but its funding volume should also be used to set up and finance local and regional energy agencies on their territories. In addition, the Modernization Fund can finance energy managers for these local and regional authorities, thereby building up their capacity to engage in stronger energy and climate action. Moreover, the Modernisation Fund should be used to build up a functioning ESCO market, which can enable these local and regional authorities to tap into their full energy efficiency potential.