

The use of auctioning revenues from the EU ETS for climate action

An analysis based on eight selected case studies

Summary

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What we can learn from the use of auctioning revenues in Czechia, Germany, Greece, France, Italy, the Netherlands, Poland, and Portugal

- 1 Reporting has significant shortcomings.** Submitted reports do not provide a good description of the financed actions as they are missing important contextual information and often include inaccuracies.
- 2 Not all auctioning revenues reported to be spent on climate action incentivise green investment.** Countries spent part of their revenues on support for fossil fuels, in particular new gas boilers, through building retrofitting programmes. Other countries include energy price compensation for industry in their reporting.
- 3 All revenues should be spent on climate action.** The EU ETS Directive must establish 100% earmarking, exclude fossil fuels and compensation payments, and improve reporting standards. External checks should safeguard spending of revenues on climate action.
- 4 National policy design must ensure traceable long-term funding.** Countries should dedicate the revenues to a limited number of institutions and actions. Ideally, more revenues go to the Modernisation Fund thereby ensuring a transparent use of revenues.

Introduction

The EU has agreed to reach climate neutrality by 2050 and enshrined this objective in the European Climate Law (ECL). Achieving this objective necessitates a transformation of the EU economies which requires significant additional investments across all sectors (COM 2018).

Auctioning revenues for climate action

One key source of climate financing could come from the auctioning revenues of the EU Emissions Trading System (EU ETS). The EU ETS generated EUR 16.5 billion of revenues in 2020 and EUR 14 billion in the first half of 2021 alone (COM 2021a). These revenues are expected to further increase due to a reduction of overall emission allowances leading to a rising carbon price as well as the phasing out of free allocation (Wiese et al. 2020, Lemmens and Mertens 2022).

Provisions in the ETS Directive

The current EU ETS Directive states that 50% of auctioning revenues from stationary auctioning (Article 10(3)) and 100% from auctioning for aviation (Article 3d(4)) should go to climate action. The ongoing revision proposes to raise the share to 100% and change the wording from 'should' to 'shall', making the provision mandatory.

In addition, the ETS Directive allows for up to 25% to be spent on industry compensation for increased electricity prices (Article 10a (6)) – this, however, does not fall under climate action.

Objective of this policy brief

This policy brief summarises eight case studies on the use of auctioning revenues, of the countries Czechia, Germany, Greece, France, Italy, the Netherlands, Poland, and Portugal. The work was conducted as part of the LIFE ETX project. The full study will be published in May 2022.

The study analyses the reporting on the use of auctioning revenues since 2013 and investigates how countries earmark their revenues and if those revenues finance additional climate action. The analysis is based on desk research and interviews with relevant experts from ministries and NGOs.

Revenues spent on climate action

In total, the eight countries received almost EUR 40 billion in revenues over the period from 2013 to 2020.

Most countries comply with the 50% share for climate action

Germany and Greece reported that 100% of their revenues went to climate action, followed by Portugal and France with roughly 90%. However, not all countries reported that they have spent the recommended share of at least 50%. The exceptions were Italy, whose share averaged 36% between 2013 and 2020 and Czechia, which for some years reported a share slightly under 50% (see Table 1).

The biggest actions financed with revenues were renewable schemes and energy efficiency programmes

According to the reporting, the biggest individual programmes financed with revenues were either renewable support schemes (Czechia, Greece, Poland and Portugal) or energy efficiency programmes for buildings (Germany and France).

However, most countries used revenues for support programmes that include subsidies for fossil fuels – most frequently for gas boilers in retrofitting programmes, which exist in Czechia, France, Germany, Italy and Poland. Poland, in addition, financed several programmes with support for oil boilers, and their most recently introduced Energy Transition Fund also provides support for fossil fuel technologies, such as gas power plants.

Earmarking and additional climate action

There are considerable differences in how countries handle auctioning revenues (see Table 1). Germany and Portugal use budgetary earmarking, *i.e.*, revenues go to a fund separate from the state budget. Czechia, Greece, France, Italy and Poland use political earmarking, *i.e.*, using specific laws for direct allocation. Additionally, Czechia ensures that revenues go to climate action by channelling part of its allowances to the Modernisation Fund. In contrast, the Netherlands directs its revenues to the state budget without any earmarking.

Earmarking does not guarantee additional climate action

The political will determines if auctioning revenues are used for additional climate action. In most countries, at least part of the revenues enabled additional action which most likely would not have happened without them. For example, Portugal used the revenues to improve their public transport system and to make it more financially accessible. Greece used part of the money for a just transition fund, supporting regions most affected by the energy transition.

However, in some cases revenues did not lead to additional climate action. For example, Czechia and Portugal used revenues to pay off the debts of a renewable support scheme. These actions do not provide additional incentive for new investments.

Moreover, new political realities can quickly lead to a deviation from the established allocation practice. For example, Greece, Portugal, and Poland recently started to use revenues to compensate households for increasing energy prices – addressing social impacts of higher prices, but not incentivising additional climate action.

For some countries, policy design for earmarking was non-transparent and not straightforward

Some countries have overly complicated allocation rules, which makes tracing revenues difficult to impossible. For example, the legislature in Poland refers to different trading periods, and allocates revenues in percentages, absolute numbers, or uses the number of allowances.

Likewise, Germany and Italy channel revenues to a great variety of ministries and implementing agencies which adds to the bureaucratic burden and hamper long-term effective financing.

In the case of Portugal, its Environmental Fund only offers one year financing for some of its projects, making structural changes difficult to implement.

Reporting needs improvement

The reported spending on climate action should be taken with a grain of salt as the analysed reports had several shortcomings.

There was limited information on revenue allocation and the specific actions

In most reports, important contextual information was missing, such as relevant laws and institutional set-up, details on the programmes, such as beneficiaries, supported technologies, type of scheme and the size of the whole programme. Thus, additional sources were needed for a good understanding of the use of auctioning revenues in these countries. The Netherlands do not report any programmes.

Countries reported industry compensation as climate action

In addition, several countries (such as Germany, Greece and Poland) report using ETS revenues for the compensation for indirect costs of industry under climate action, which should not be considered as

such. The Netherlands has no earmarking, but they spend the equivalent of about a third of auctioning revenues on industry compensation.

There were inconsistencies in almost all of the reporting

There were inconsistencies in almost all of reporting, such as the total reported amount spent on climate action not matching the sum of listed programmes, errors of conversion and inconsistent use of units, amongst others. These were not corrected afterwards.

Recommendations

Countries should use all auctioning revenues as a lever for additional climate action. To ensure this, stronger external checks are needed. Hence, based on our analysis, we see the following necessary improvements:

The ETS Directive should exclude fossil fuels and compensation payments

The ETS Directive's current definition of climate action (Article 10 (3)) leaves room for interpretation. Thus, it should clearly exclude programmes that support fossil fuels. In addition, compensation payments for high energy prices for industry and possibly households should not be included if they do not incentivise climate investment.

All revenues must go to climate action

The share of auctioning revenues for climate action must be 100%. This would support the required shift to climate neutrality and would most likely increase public support for carbon pricing (see Maestre-Andrés et al. 2019).

The review of auctioning revenue use only seems reasonable if there is a mandatory requirement for which the countries can be held accountable. Thus, the provision for the share of auction revenue use in the ETS Directive needs to change from 'should' to 'shall'. This is in line with the

new proposal of the EU ETS Directive of the EU Commission (COM 2021b).

Earmarking must be mandatory and well-designed to allow traceability and checks of revenue spending

Earmarking makes revenue use accountable. While earmarking does not necessarily guarantee that revenues are spent on climate action, it is necessary to make revenue use comprehensible and makes external checks possible.

Good earmarking is straightforward in its points of reference; it should always use the same time frames and units as well as specify the amounts clearly. It should directly refer to specific programmes or funds, rather than to vague purposes. It should stipulate allocation over a longer period and limit the number of actors involved.

The Modernisation Fund should be extended to complement national earmarking

The Modernisation Fund, in its current form, contains a system of external checks that aims to ensure good practices. Therefore, expanding it in terms of its volume and number of recipients ensures more revenue is spent on climate action.

The reporting template should cover relevant legislation and specific information on financed actions

An expanded template should request information on relevant the laws and legislation which determine yearly allocation of revenues. Moreover, information about the programmes should include the exact support mechanism, recipients, overall size and supported technologies.

Reporting should use digital tools

A more standardised digital tool could help prevent the entry of inconsistent data in the reporting. Moreover, for multi-year programmes, the data entry tool could provide a template and check consistency.

Table 1: Overview of case studies

	Share of climate action (*)	Earmarking	How are revenues allocated?	Financed fossil fuel technologies	Compensation payments for Households	Industry
Czechia	77%	Partially (up to a cap)	Earmarking up to CZK 8 billion, half goes to the Environmental Fund and half to the Ministry of Industry and Trade; plus additional revenues (according to reporting). For 2021-2030, part of allowances goes to the Modernisation Fund.	Gas boilers (Retrofitting programme)	No – Currently being discussed	Payments exist, financed from state budget (**)
Germany	100%	Yes	All revenues go to the Energy and Climate Fund (implemented through several ministries).	Hybrid gas boilers (Retrofitting programme)	Somewhat (revenues for cancelling EEG surcharge)	Yes, 11% of revenues in 2020
Greece	~100%	Yes	Legislation specifies purposes, yearly ministerial decrees that decide upon exact allocation.	CHP with gas (RES support scheme)	Yes, 75% of revenues in 2022	Yes, 17% of revenues in 2020
France	91%	Partially (up to a cap)	Allocation of revenues up to a cap to the French Housing Agency, which uses it for a building retrofitting programme. Rest goes into the state budget.	Gas boilers (Retrofitting programme)	Payments exist, financed from state budget	Payments exist, financed from state budget
Italy	36%	Yes	Legislation allocates 50% to climate action and specifies responsible ministries; yearly ministerial decrees decide on amounts per ministry and for certain funds.	Gas boilers (Retrofitting Programme)	Currently discussed	Currently discussed
The Netherlands	No info	No	Due to the separation of budget and expenditure, there is no earmarking. Everything goes to the state budget.	No info	No info	Payments exist, financed from state budget
Poland	52%	Partially	Poland allocates all revenues to the state budget. Legislation earmarks 50% for climate action and specifies some purposes and funds.	Oil and gas boilers (Retrofitting programme)	Yes, electricity price was frozen for the year 2019	Yes, 5% of revenues in 2020
Portugal	92%	Yes	Legislation allocates all revenues to the Environmental Fund. Yearly decree decides on the specific programmes financed through the fund.	CHP with gas (Support scheme, no longer financed with revenues)	Yes, since 2021	Yes, since 2021

Source: Own compilation based on case studies; without information on international spending. Abbreviations: EEG = Renewable Energy Act, CHP = Combined Heat and Power Plant (*) Average over the years 2013-2020. (**) Grey marked texts highlights information not related to the use of auction revenue

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