

# USING EU ETS AUCTIONING REVENUES FOR CLIMATE ACTION

WHAT IS THE APPETITE FOR EARMARKING WITHIN SPECIFIC EU MEMBER STATES?

Anja Esch

With contributions from

Ilona Jedrasik, Polish Climate Coalition

Alix Mazounie and Celia Gautier, RAC France

Petr Holub, Šance pro budovy

Istvan Bart, Hungarian Energy Efficiency Institute (MEHI)

Jiri Jerabek, Greenpeace Central Eastern Europe

Niklas Kaskeala, Kepa Finland

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**Author:** Anja Esch

With contributions from Iлона Jedrasik, Polish Climate Coalition; Alix Mazounie and Celia Gautier, RAC France; Petr Holub, Šance pro budovy; Istvan Bart, Hungarian Energy Efficiency Institute (MEHI); Jiri Jerabek, Greenpeace CEE; Niklas Kaskeala, KEPA

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Office Berlin

Schiffbauerdamm 15

D-10117 Berlin

Phone +49 (0) 30 2888 356-0, Fax -1

Office Bonn

Dr. Werner-Schuster-Haus

Kaiserstr. 201

D-53113 Bonn

Phone +49 (0) 228 60492-0, Fax -19

Internet: <http://www.germanwatch.org>

E-mail: [info@germanwatch.org](mailto:info@germanwatch.org)

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# 1 Introduction

The European Union Emission Trading Scheme (EU ETS) is facing serious problems. Clear decisions are necessary to ensure that the EU ETS will realise its double potential during the third EU ETS period as a key instrument for a cost efficient path to a 80-95 % GHG reduction until 2050 and set the right incentive for low-carbon-investment and at the same time generate urgently needed revenue for national and international climate action.

Against this background, and taking into account the uncertain future of the EU ETS, it might in the short term seem misplaced to look at the EU ETS as a finance source. Focusing on the question of the current relevance of earmarking within the EU member states may seem inopportune.

However, we still see the ETS as the flagship of EU climate policy and the urgent need to increase the linear factor in a way that is coherent with the long term climate targets of the EU (55 % until 2030). The ETS revenues could become an essential funding source already during the second and then the third EU ETS period. Starting in 2013, at least half of the allowances are being auctioned – and hence, much more and stable revenues could be generated (with the appropriate framework conditions).

The paper will shed light on the potential of the EU ETS as a finance instrument. The first chapter shows how EU ETS revenues could help meet the financial needs for climate-actions and briefly discusses the current problems with the EU ETS.

We want to “reactivate” the question regarding earmarking the EU ETS revenues. Hence, the second chapter focuses on the earmarking approach and whether earmarking is a sensible means. In addition, we present Germany as a case study of earmarking ETS revenues for climate finance.

The third chapter contains the case studies of seven EU member states: the state of play of the use of EU ETS revenues is presented and the suitability of earmarking in each respective country is discussed. Our country case studies show that these EU Member States have prepared plans for the use of the EU ETS revenues (in line with the ETS directive). However, in some countries the spending plans are still under discussion. In these seven EU Member States at least, the EU ETS could also work as an innovative finance source for climate action. But this would require the necessary decisions for repairing the ETS to be taken soon.

## 2 Addressing the needs – Using EU ETS revenues for climate-related expenditures

### 2.1 *Climate financing needs – domestically and globally*

Since the so-called “Stern report”, it is commonly acknowledged that a delay in climate action will be very costly. It is estimated that non-action in this regard will be comparable to losing at least 5 % of global GDP, whereas the costs of early action would be limited to around 1 % of global GDP p.a. (Stern 2006). Scenarios in recent scientific literature still confirm this assumption; indeed, the cost of staying below a 2°C-pathway might now be less than 1 % of global GDP. But the longer climate action is postponed, the higher the cost will be and the more complicated the technological hurdles will become (Climate action tracker 2012).

Given the current financial and economic crisis faced by most industrialized countries, it is a major challenge to provide sufficient financial support globally and domestically for the “great transformation”. It means domestically nothing less than financing a paradigm shift from the fossil fuel society to a post-fossil fuel society (WGBU 2011). Given that an industrialized country like Germany wants to achieve an emission reduction of 95 % by 2050, this would result in a financial burden of up to 0.6 % national GDP (WWF 2009).<sup>1</sup>

The developed world has to face another important financial burden – namely providing financial resources to international climate financing: the industrialized countries committed in Copenhagen 2009 and Cancun 2010 to provide financial resources for climate actions in developing countries of 30 billion USD as Fast Start Finance (FSF) for the period 2010 to 2012. Additionally, they committed to mobilizing 100 billion USD p.a. by the year 2020 for international climate actions. Now after the FSF-period, developed countries need to scale up their financial support for poor countries in a predictable and transparent way. The current UNFCCC report on long-term finance emphasises that climate financing needs of developing countries exceed the current climate finance flows and that urgent action is necessary (UNFCCC report 2012). Unfortunately, at the recent climate conference in Doha 2012 industrialized countries failed to clarify how they will deliver on their financial commitment by the year 2020. This is particularly disheartening when one considers that the actual financial needs are significantly higher than 100 billion USD: for developing countries, the World Bank estimates costs of about 140-175 billion USD for mitigation and about 30-100 billion USD for adaptation (World Bank 2011). How to finance these urgently needed climate actions, both domestically and globally, remains a crucial question for both industrialized developing countries.

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<sup>1</sup> In Germany this would mean an annually low-carbon investment of up to 14 billion EUR.

## **2.2 EU ETS revenues – A promising source for international and national climate financing?**

Recent studies and reports have recommended carbon pricing as an innovative finance source because it offers dual benefits: it provides incentives for mitigation and it helps raise revenues for climate actions. It can be implemented through a carbon tax or fee by setting a fixed price or through emissions trading by setting a fixed climate target and allowing the market to set the price (AGF 2010, World Bank 2011).

With the establishment of the EU ETS, the EU has already implemented carbon pricing – as recommended by AGF and World Bank. The EU ETS the largest cap-and-trade system worldwide; however, it has become entirely ineffective with regard to reducing emissions and generating revenues.

In a fixed EU ETS system, revenues generated by auctioning the emission allowances under the EU ETS could be considered as the largest – and most promising – innovative financing source within the European Union. If the right framework conditions were provided (mainly by a linear factor sufficient to meet the agreed long term targets), these auctioning revenues could potentially deliver revenues of more than 20 billion EUR per year by 2020 (EC 2011).

However, without the implementation of an ambitious European climate policy the EU ETS is losing its impact as an instrument for reducing emissions and for generating revenues.<sup>2</sup>

### **2.2.1 The use of the EU ETS revenues: The recommendation of the EU ETS directive as a compromise**

In 2008, the question of whether or not the EU ETS revenues should be used (respectively earmarked) for funding climate action was intensively discussed among EU decision-makers<sup>3</sup>. The environment committee of the European Parliament wanted the EU ETS revenues to solely finance climate-related measures, with at least 50 % (only 20 % was suggested by the Commission) of the revenues provided for climate financing in developing countries and the remainder used to fund climate-related projects within the EU (Müller 2008).

In the end, a binding arrangement for the use of the EU ETS revenues could not be agreed upon. The European Council declaration states that:

“Member States will determine, in accordance with their respective constitutional and budgetary requirements, the use of revenues generated from the auctioning of allowances in the EU emissions trading system. It takes note of their willingness to use at least half of this amount for actions to reduce greenhouse gas emissions ...” (EU council 2008).

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<sup>2</sup> If the back-loading approach is sufficient for stabilisation. the certificate price will be briefly discussed in section 2.2.3

<sup>3</sup>The EU Commission and the Parliament supported this approach, but some of the new EU Member States opposed it.

This non-binding nature in terms of using the EU ETS revenues is also reflected in the EU ETS directive which recommends that at least 50 % should be used for climate action. The EU directive mentions a variety of different possible uses for ETS revenues – mainly for domestic climate but also international climate financing (EU directive 2009/29/EC).<sup>4</sup> Also the “willingness” of member states “to use at least half of this amount for actions to reduce greenhouse gas emissions” is a good basis for action within the Parliament or from civil society.

## 2.2.2 The EU ETS and its recent problems: Need for reparation to increase the certificate price

As mentioned above, the EU ETS is currently unable to unlock its twin potential. The volatility and break down of the certificate price is clearly hampering the possibility of EU ETS becoming an innovative source of finance. Although the EU predicted a price of 40 EUR per t/CO<sub>2</sub> when the EU ETS was created, the price is currently less than 4 EUR per t/CO<sub>2</sub> (EC 2008).

Several factors influence the certificate price; however, the recent economic crisis within the European Union and the use of external emission reduction credits from Clean Development Mechanism and Joint Implementation are the main factors for the price decline. Hence, a surplus of emission allowances on the market has lowered the certificate price (WWF 2012). To counter this effect, a new binding European reduction target for greenhouse gas emissions is urgently needed, with an EU emission reduction target for 2020 strengthened to 30 % (compared to 1990)<sup>5</sup>, respectively an ambitious emission target for 2030 (55 %), on a cost efficient path towards 2050 targets (80-95 %). The linear factor has to be increased in line with those targets. The so called back-loading approach can only be a first step towards such a structural reform. Back-loading would temporarily reduce the volume of emission allowances by postponing 900 million allowances from 2013 – 2015 to the end of the third emission trading period in 2020 (EC 2012). Even though the environment committee of the European Parliament supported the back-loading measure, the European Parliament itself did not support it in mid-April 2013. However, the proposal will go back to the Environment Committee for further consideration. A decision is expected by June 2013 (EU Parliament 2013) or early July. However the situation is difficult, mainly because the German Government declines to send a supportive signal. Table 1 shows how the different approaches influence the ETS revenues per EU Member State.

<sup>4</sup> ETS-Directive 2009/29/EC, Article 10 states: “Member States shall determine the use of revenues generated from the auctioning of allowances. At least 50 % of the revenues generated from the auctioning of allowances [...] should be used for one or more of the following: (a) to reduce greenhouse gas emissions, including by contributing to the Global Energy Efficiency and Renewable Energy Fund and to the Adaptation Fund [...], (b) to develop renewable energies [...](c) measures to avoid deforestation [...] (d) forestry sequestration in the Community; (e) the environmentally safe capture and geological storage of CO<sub>2</sub>, in particular from solid fossil fuel power stations; (f) to encourage a shift to low-emission and public forms of transport; (g) to finance research and development in energy efficiency and clean technologies in the sectors covered by this Directive; (h) measures intended to increase energy efficiency and insulation or to provide financial support [...] (i) to cover administrative expenses of the management of the Community scheme.”

<sup>5</sup> instead of the current 20 %

**Table 1: Auctioning revenues per Member State according to different scenarios (WWF 2012)<sup>6</sup>**

	Auctioning revenues					Increase in auctioning revenues			
	Ref- erence	Back- loading	Long- term set- aside	25 % domestic	30 % domestic	Back- loading	Long- term set- aside	25 % domestic	30 % domestic
	billion €								
<b>Total</b>	<b>85</b>	<b>92</b>	<b>97</b>	<b>148</b>	<b>163</b>	<b>6</b>	<b>12</b>	<b>62</b>	<b>78</b>
Austria	1.2	1.3	1.4	2.2	2.4	0.1	0.2	0.9	1.2
Belgium	2.3	2.4	2.6	4.0	4.4	0.2	0.4	1.7	2.1
Bulgaria	1.9	2.1	2.1	3.2	3.5	0.2	0.2	1.3	1.6
Cyprus	0.1	0.2	0.1	0.2	0.2	0.0	0.0	0.1	0.1
Czech Republic	3.1	3.4	3.4	5.1	5.6	0.3	0.2	2.0	2.5
Denmark	1.1	1.2	1.3	2.0	2.2	0.1	0.2	0.9	1.1
Estonia	0.6	0.7	0.6	1.0	1.1	0.1	0.0	0.4	0.5
Finland	1.5	1.6	1.7	2.6	2.9	0.1	0.2	1.1	1.4
France	5.1	5.5	6.0	9.1	10.1	0.3	0.9	3.9	5.0
Germany	17.8	19.1	20.7	31.3	34.7	1.3	2.8	13.4	16.9
Greece	3.1	3.3	3.6	5.4	6.0	0.2	0.5	2.3	2.9
Hungary	1.0	1.1	1.0	1.6	1.7	0.1	0.1	0.6	0.8
Ireland	0.9	0.9	1.0	1.5	1.7	0.1	0.1	0.7	0.8
Italy	8.6	9.2	9.9	15.0	16.7	0.6	1.4	6.4	8.1
Latvia	0.2	0.3	0.3	0.4	0.5	0.0	0.0	0.2	0.2
Liechtenstein	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lithuania	0.4	0.5	0.5	0.8	0.9	0.0	0.1	0.3	0.4
Luxembourg	0.1	0.1	0.2	0.2	0.3	0.0	0.0	0.1	0.1
Malta	0.1	0.1	0.1	0.2	0.2	0.0	0.0	0.1	0.1
Netherlands	3.1	3.3	3.6	5.5	6.1	0.2	0.5	2.4	3.0
Norway	0.5	0.6	0.6	1.0	1.1	0.0	0.1	0.4	0.5
Poland	7.0	7.8	7.2	10.9	11.6	0.8	0.2	3.9	4.6
Portugal	1.6	1.7	1.8	2.8	3.1	0.1	0.3	1.2	1.5
Romania	3.7	4.0	4.1	6.3	6.9	0.3	0.4	2.6	3.2
Slovakia	1.3	1.4	1.5	2.3	2.6	0.1	0.2	1.0	1.2
Slovenia	0.4	0.4	0.4	0.7	0.7	0.0	0.1	0.3	0.4
Spain	7.8	8.3	9.1	13.7	15.2	0.5	1.3	5.9	7.4
Sweden	0.8	0.9	1.0	1.4	1.6	0.1	0.1	0.6	0.8
United Kingdom	9.7	10.4	11.4	17.2	19.2	0.7	1.6	7.5	9.5

Source: Calculations by Öko-Institut

<sup>6</sup> The reference scenario is based on an average certificate price of 10.25 EUR, the back-loading approach is based on the scenario that 1.2 billion EURs will be postponed by 5 years (see WWF 2012). At the moment it can be assumed that, without back-loading, the average certificate price will be 5 EUR during the 3<sup>rd</sup> EU ETS period, meaning only half of the reference scenario amount will be achieved within the 3<sup>rd</sup> EU ETS period.



## 3 Earmarking: A sensible means?

### 3.1 Budgetary earmarking: Advantages and disadvantages

It is up to each EU Member State to decide “in accordance with their respective constitutional and budgetary requirements” (EU council 2008) on the use of its EU ETS revenues. However, it can be assumed that within the EU Member States earmarking of the EU ETS revenues causes resistance. The budgetary right is a key right of any parliament. Parliamentarians give high priority to the annual decision on the expenditures of the general budget (e.g. Grupp 2000). Earmarking is often regarded as a limitation of this key right to decide on the general budget, resulting in scepticism.

In principle, earmarking allows revenues to be dedicated to a certain purpose. In order to do so, these revenues are separated from the national budget. This “off-budget” separation avoids the revenues to be spent within the general budget plan. In certain states the earmarking of revenues has become a common practice e.g. in the United States and in Great Britain, since both countries have implemented revenue raising schemes on the basis of a sort of earmarking. In the US, for example, at least 19 earmarking schemes are already in use (Müller 2008).

Even though earmarking has become a common practice in some countries, it remains a controversial subject. *Ulbrich, Desbarats, Müller and McCleary* identify the following advantages and disadvantages of earmarking (with relevance for the EU ETS revenues):

They claim there is no general prejudice against earmarking. Bundling expenditures and revenues can even make a tax or fee more acceptable for people, especially when the tax is directly linked to its area of application. When the affected tax payer benefits directly from particular taxation, it can be considered a kind of “benefit principle”, for example the gasoline tax, which is used for highway construction. Those who demand the service should therefore pay for it – not the taxpayers in general, as an imperative of fairness (e.g. impact fee). This “benefit principle” or “user pays principle” helps to justify the need for earmarking (Ulbrich 2010; McCleary 1989). And it helps to increase the transparency of public spending (Wilkinson, 1994; Desbarats 2012).

In addition, earmarking may defend priority programs from changing majorities; thereby ensuring a minimum level of financing and avoiding periodic bargaining about the appropriate level of funding. This can help to guarantee stable and predictable expenditures (McCleary 1989; Müller 2008). The “ambivalent nature” of earmarking is closely linked to this: defining long-lasting priority programs may appear advantageous, given that the priority of certain programs is not called into question. However, this can be regarded as a disadvantage due to its bias towards locking in spending priorities, and – as a consequence – making it difficult to shift the funding to another policy priority (Desbarats 2012). Finally, defining priority programs limits the decision on the general budget and affects the parliamentary key right, as described above.

An appropriate allocation of resources for the relevant policy program is very difficult to achieve by earmarking revenues. If too many revenues are generated, there is a risk of wastage. Furthermore these revenues are not available for other purposes. If too little is generated, it is hard to fight for additional funding out of the general budget (Ulbrich 2010). This means that earmarked funds remain dependent on government decisions.

Instead of readjusting taxation and pricing in order to increase the needed revenues, the earmarking set-up will normally be suspended by the government. That is the main reason why scholars conclude that earmarking has been generally unsuccessful (Desbarats 2012; McCleary 1989).

### **3.2 Political earmarking: What does this mean?**

Due to general concerns regarding budgetary earmarking, it can be assumed that few EU Member States will follow this path when it comes to EU ETS revenues. An alternative model of earmarking could be so-called “political earmarking”. Political earmarking enables revenues and expenditures to be linked without an off-budget separation.

A prominent example for this kind of political earmarking is the Ecotax<sup>7</sup> in Germany. The government intended the Ecotax to reduce harmful energy consumption and for the tax revenues to stabilise the pension insurance contribution rate. The Ecotax is considered a “double dividend” (Lobsien 2009).

The latter effect of the “double dividend” has been achieved by establishing a political earmarking of the tax revenues. A separate law was laid down stating revenues generated by the Ecotax should be used for stabilising the contribution rate towards pension insurance. Political earmarking works without establishing a separate budget structure. It is important that the political will to use the relevant revenues for certain expenditures has been declared within a distinct law. In this case only the appropriation of the revenues can be fixed –it is not possible to *bundle* the expenditures in a transparent way (this is possible within a separate budget structure).

Other so called “bound budgets” exist within the general German budget, e.g. expenditures determined by social security regulation (Eickenboom 1989).

### **3.3 Case study Germany: The Special Energy and Climate Fund**

Germany is the only country within the European Union to set-up a full budgetary earmarking of its ETS revenues for national and international climate financing.

In 2010 the German government established the Special Energy and Climate Fund (in German: ‘Sondervermögen Energie und Klimafonds’ (EKF)), a separate budget structure. Initially, this new fund should have been partially be financed by the profit backflow from the nuclear power sector and by EU ETS revenues. After the introduction of the “Energiewende” (turnaround in energy policy) and the nuclear power phase-out in 2011, the income concept of the fund was revised. Since 2012 nearly all EU ETS revenues (including the EU ETS revenues from the aviation sector) flow into the EKF. In Germany, true – not just political – appropriation of revenues is only permitted within the framework of a separate budget structure, a “special fund” (in German: ‘Sondervermögen’) (Esch 2012).

<sup>7</sup> The so-called „Ökosteuern“ was introduced by the Red-Green Federal Government in 1999 (official: Gesetz zum Einstieg in die ökologische Steuerreform)

The establishment of the EKF has facilitated not only the earmarking of the EU ETS revenues, but also the bundling of climate-related expenditures. This bundling of expenditures – as indicated above – is only possible within a separate budget structure. In particular, when different ministries are responsible for allocating expenditure (as with the EKF), bundling expenditures enhances transparency of EU ETS revenue use.

In November 2012 the German parliament decided the expenditures to be financed through the EKF (based on a certificate price of 10 EUR – see table 2). According to the recent benchmark figures for the general budget 2014 and the EKF, presented by the German government in March 2013, the EU ETS revenue expectations have been adjusted. Now the government assumes EU ETS revenues for 2014 of about 900 million EUR (based on a certificate price of 4.50 EUR) (Federal government, 2013).

**Table 2: Expected EU ETS revenues for the EKF (Federal government 2012, 2013)**

Expected ETS revenues	Fiscal year 2013 in mil. EUR
<b>Old: On the basis of a 10 EUR certificate price (in 2012)</b>	<b>2,180.0</b>
<b>New: On the basis of a 4.50 EUR certificate price (in 2013)</b>	<b>888.5</b>

**Table 3: EKF revision of revenues for 2013 fiscal year (Ministry of Finance 2013)**

Fiscal year 2013	
Revision of revenues for EKF	in mil. EUR
<b>New: EU ETS revenues based on a certificate price of 4.50 EUR</b>	888.5
<b>Reserve</b>	194.7
<b>Substitution by KfW<sup>8</sup></b>	311.0
<b>Total</b>	<b>1,394</b>

For the current fiscal year, 2013, the Ministry of Finance submitted a report to the Budget Committee of the German parliament outlining:

- a revision of the *revenue* side of the EKF due to the low certificate price
- an *expenditures* adjustment (based on the new amount of 1,394 million EUR (instead of 2,180 million EUR))

<sup>8</sup> KfW (Kreditanstalt für Wiederaufbau), the German government-owned development bank, provides its own resources as a substitute for lost EU ETS revenues

**Table 4: Comparison – expenditures adjustment 03/2012 (based on the new amount of 1,394 mil. EUR) and original spending plan 04/2013 (based on old amount of 2,180 mil. EUR)**

<b>Fiscal year 2013</b> <i>Expenditures of the EKF</i>	<b>Old: Original spending plan (proposed 03/2012)</b>	<b>New: Adjusted spending plan (revised 04/2013)</b>
	<b>in mil. EUR</b>	
<b><i>Political focus (national):</i></b>	342.0	197.0*
CO <sub>2</sub> building restoration and energetic urban renewal		51.0*
		12.8*
Compensation of energy costs (because of emission trading) for electricity-intensive enterprises	---	---
Programme electromobility	426.1	426.1
Renewable Energy	340.0	83.3
		73.7
		25*
Energy Efficiency	304.5	69.4
		63.0
National climate action programmes	208.0	96.4
		8.0
		7.0
Refunding liquidity loans / removal from reserve fund	165.5	-
<b><i>Political focus (international):<sup>9</sup></i></b>	394.0	256.5
International Climate Financing (incl. environmental protection)		25.2*
<b><i>Total amount</i></b>	<b>2,180</b>	<b>1,394</b> *includes KfW funds

<sup>9</sup> Note: According to the benchmark figures of the 2014 Budget Plan (see: Federal Government 2013), the German government is going to shift these expenditures from the EKF to the general budget.

Regarding fund allocation, the main criticism so far is that the German government wanted to spend revenues on compensating energy-intensive companies for higher energy prices (expected to start 2014). This was based on competition arguments. Promoting electromobility as an industrial policy approach through the EKF is also contentious. However, there has been one very positive development: the German government dropped the plan to subsidize fossil power plants through the energy efficiency budget line (due to the strict EU guidelines).

Despite the serious problems faced by the EKF as a result of the low certificate price, this separate budget structure is still justified and should be maintained as far as possible. If the right framework conditions for stabilising the certificate price are implemented, the EKF could reach its potential.

In our view, the following approaches have finally been fulfilled within the EKF and demonstrate its potential (Esch/ Kowalzig 2012):

- **Earmarking according to the polluter-pays-principle**

The full budgetary earmarking of the EU ETS revenues represents an important step forward. As a result of this earmarking, the financing of the energy shift (*Energiewende*) in Germany and the German contribution to international climate finance are partially based on the *polluter-pays-principle*. This is a very innovative approach, because it leads to a kind of self-financing climate regime. Here the polluter-pays-principle is related to the benefit-principle: it sets an incentive to reduce harming the climate (“the polluter pays”) and those harmed, the climate and affected people, benefit from the revenues. In this respect, further financing sources, which are based on the polluter-pays-principle, are eligible to enlarge EKF’s revenue pool. An appropriate financing source, which in principle follows the polluter-pays-approach (it addresses polluters, but not in relation to their exact emissions), would be revenues generated by the ticket tax (*Luftverkehrssteuer*).

- **Transparency of EU ETS-revenue use**

The bundling of expenditures for climate action within the EKF makes the national and international allocation of EU ETS revenues easy to track. If the EU ETS revenues are not used in a truly climate-related way, these expenditures are easy to identify; offending items can be easily reported to the public or opposed in Parliament. Some examples have been mentioned above, e.g. compensating energy-intensive companies for higher energy prices. As long as a global system for measuring, reporting and verification (MRV) for international climate financing is not implemented, the transparency issue is extremely relevant, especially where international climate negotiations are concerned.

- **Signal effect for international climate negotiations**

For international climate negotiations, the transparency of the use of the EU ETS revenues for international climate financing actually provides additional value. It can serve as a trust building element between industrialized countries and developing countries; therefore this approach could create a positive signal effect for the on-going climate negotiations.

## 4 Appetite for earmarking within specific EU Member States?

The use of EU ETS revenues is relevant for other EU Member States. What is the state of play regarding their discussion? Are there any decisions within other EU member states for the use of EU ETS revenues? Is there also a discussion on earmarking the EU ETS revenues – in a budgetary or political way? Finally, would such an earmarking approach be applicable within other EU member states?

These issues will be looked at for the following EU member states:

EU Member State	Total expected revenues (billion EUR) 2013-2020. <sup>10</sup>	Use of EU ETS revenues for climate action? (national / international)	Establishment of new fund? (bundling of expenditures)	Earmarking of EU ETS-revenues applicable? (budgetary / political)
Poland*	3.5 - 7	National: Possibly 50 % of the revenues, or the equivalent, will be spent on climate protection and adaptation issues	Ministry of Economy supports the idea of allocating EU ETS revenues to a special fund (still under discussion)	Earmarking is possible under Polish law.
France	2.5 - 5.1	National: “up to 590 million EUR” (at the time, expected to be a 100% of revenue) for the National Housing Agency retrofitting of social housing	No	Political earmarking, but enshrined in the 2013 finance bill.
Romania*	1.85 - 3.7	National: 71 % go to projects submitted by various ministries to (and approved by) the National Administration of the Environmental Fund.	Existing Environmental Fund will be used.	Political earmarking seems to be possible.
Czech Republic*	1.5 - 3.1	National/International: “at least” 50 % is earmarked.(goes to energy efficiency in buildings, international climate finance and energy efficiency in district heating and industry)	Existing State Environmental Fund will be used for financing energy efficiency in buildings and international climate finance.	Budgetary earmarking is given by the legislation

<sup>10</sup> See: WWF 2012 (see also section 2.2.3). Note: WWF’s reference scenario is based on an average certificate price of 10.25 EUR (leading to the higher amount in the table). At the moment it can be assumed that without back-loading the average certificate price will be about 5 EUR (leading to the lower amount in the table) for the 3<sup>rd</sup> EU ETS period.

EU Member State	Total expected revenues (billion EUR) 2013-2020. <sup>11</sup>	Use of EU ETS revenues for climate action? (national / international)	Establishment of new fund? (bundling of expenditures)	Earmarking of EU ETS-revenues applicable? (budgetary / political)
Finland	0.75 - 1.5	International: 100 % to ODA (“climate action within development cooperation”)	Extra-budgetary funds are seen as undesirable and possibly unconstitutional	Currently only political earmarking seen as possible
Hungary*	0.5 - 1	National Climate Law decided that 50 % of auction revenues should be used for climate change-related spending	2013 Budget Law contains a Green Economy Development System (with 17 million EUR) – which is presumably coming from auction revenues	Political earmarking: National Climate Law decided that 50 % of auction revenues should be used for climate change-related spending

\*Some member states are eligible to be exempted from auctioning under the derogation: Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland and Romania.

<sup>11</sup> See: WWF 2012 (see also section 2.2.3). Note: WWF’s reference scenario is based on an average certificate price of 10.25 EUR (leading to the higher amount in the table). At the moment it can be assumed that without back-loading the average certificate price will be about 5 EUR (leading to the lower amount in the table) for the 3<sup>rd</sup> EU ETS period.

## **4.1 Case studies of specific EU Member States (state of play/earmarking applicable?)<sup>12</sup>**

### **4.1.1 Case study: Poland**

By Ilona Jedrasik, Policy officer in Polish Climate Coalition

#### **Political commitments**

Lack of public debate on the EU ETS revenues in Poland and little interest from politicians and media is significant, particularly in comparison to other EU ETS-related issues such as back-loading and derogation which are widely discussed in the media and among politicians and experts. At the same time, EU ETS revenues are a hot issue inside the government as different ministries have their own view on who should manage the revenues and how it should be used within Poland. The topic will be broached in the new Act on the greenhouse gas emission allowance trading system, since the outcome is very uncertain, no project resulting from this new Act has been drafted yet.

Governmental debate on EU ETS revenues started in March 2012 when the Polish Ministry of Environment published a draft of the new Act on a greenhouse gas emission allowance trading system. The new legislation is designed to implement the 2009/29/EC directive and other European laws to ensure the proper work of the emission trading system in the third commitment period of the EU ETS. The new act should have been accepted and implemented into Polish law by January 2013, but because of the proposed back-loading of emission trading allowances by the European Commission in autumn 2012, work on the act has been delayed. Vice Minister of Environment, Beata Jaczewska, maintains the decision depends on the amount of allowances left on the carbon market after 2013.

It is very likely that 50 % of the revenues, or the equivalent, will be spent on climate protection and adaptation issues. In reality, this means that if EU ETS revenues are higher than the total amount spent on climate issues from other earmarked financing sources in a given year, the Council of Ministries' resolution will determine a list of targets on which the remainder will be spent. The Polish government intends to calculate all current expenses and allocate goals in different earmarked funds and budget categories, in particular those from the National Fund of Environment Protection and Water Management (NFOSiGW), which conducts numerous climate protection and adaptation projects.

#### **Possibility of earmarking**

The Ministries of Environment, Finance and Economy presented their views on using additional revenues for climate issues (when expenses from other sources are lower than EU ETS revenues amounts in a given year). The Ministry of Environment would like to earmark the revenues for supporting energy and industry installations which are being modernized in order to decrease allowance supply in different sectors.

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<sup>12</sup> Unlike other chapters, the citation (for references) in this chapter uses footnotes.



The Ministry of Economy supports the idea of allocating EU ETS revenues to a special fund and determining their use for the whole third period (2013-2020). The Ministry intends to earmark a low-emission transformation of the Polish economy and modification of the renewable energy support scheme.

In the Ministry of Finance's view, goals and support instruments should be determined by the National Programme of Low-Emission Economy Development. The National Programme is being prepared by the Ministry of Economy, ostensibly as a strategy of CO<sub>2</sub> emission reduction in different sectors of the economy with a focus on social and economic costs and benefits. However, the draft is too general and being prepared with little ambition (without any sectoral or overall reduction targets).

#### **4.1.2 Case Study: France**

By Alix Mazounie and Célia Gautier from Climate Action Network France

##### **Political commitments**

In the past two years, environmental NGOs advocated strongly for French EU ETS revenues to be used in accordance with the recommendations by the Climate-Energy package: for climate action, domestically and internationally.

This was a logical application of the polluters-pay principle and of the EU legislation adopted under the French presidency in 2008. Also, French NGOs considered EU ETS revenue to be a key source of innovative climate finance in the context of the 100 billion USD commitment made in Copenhagen and advocated for a basket of sources of finance to reach this 100 billion, including EU ETS revenues.

In the run up to the adoption of the 2013 Finance Bill<sup>13</sup> around October 2012, the French government decided to earmark “up to 590 million EUR to the National Agency for Housing”<sup>14</sup> for the retrofitting of social housing. The commitment was enshrined in the 2013 Finance Bill adopted by Parliament. At the time, 590 million EUR was the estimated revenue from the EU ETS stream in 2013. Unfortunately, the current carbon price means that the revenue will be much lower than expected: approximately 200 million EUR in 2013. The actual revenue will depend on whether short term and structural measures are put in place in 2013 at the EU level in order to strengthen the carbon price.

##### **Possibility of earmarking**

Traditionally, the French administration, particularly the Finance Ministry, is in principle opposed to earmarking. They argue that it is economically inconsistent to earmark in the absence of certainty on the incoming stream of revenue. However, there are a number of cases of earmarking precedents in France: most recently, an extra-budgetary fund was created for international forest protection in the context of climate change (REDD+) to be replenished through the sale of French AAU surpluses from the 1st Kyoto Protocol period.

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<sup>13</sup> <http://www.economie.gouv.fr/files/projet-loi-finances-2013-plf-dispositions-budgetaires.pdf>

<sup>14</sup> [http://www.lesechos.fr/06/08/2012/LesEchos/21242-012-ECH\\_compromis-sur-le-budget-des-logements-sociaux.htm](http://www.lesechos.fr/06/08/2012/LesEchos/21242-012-ECH_compromis-sur-le-budget-des-logements-sociaux.htm)

In the French legislation, there are different understandings and strengths of earmarking. In this case, the money was earmarked within the overall budgetary framework and did not imply the creation of an extra-budgetary fund. In the case of EU ETS allowances and the National Housing Agency, the earmarking commitment is on the revenue, not on the total amount of subsidies for the Agency. In other words, the State has made no commitment to use part of its general budget for the Agency's 2013 budget. In addition, earmarking in this case did not imply the creation of an extra-budgetary fund. De facto, this means that the earmarking value is not as strong: it is less transparent since parliamentarians cannot easily track it (as is the case with an extra-budgetary fund). It will be difficult to find out the actual extent to which money was used by the National Housing Agency for retrofitting.

On the other hand, weaker earmarking can also help when the stream of revenue is much lower than expected: in the case of an extra-budgetary fund, the fund will spend money based on the incoming volume of revenue. If there is no money – as has happened in the case of the extra-budgetary fund created to fund international forest protection – the actions are not implemented. In the case of weak earmarking, there is more political space to call on the government to make up for the National Housing Agency's losses due to low EU ETS revenue in 2013.

The earmarking is only valid for 2013 and earmarking in 2014 will need to be renegotiated. The question remains open on whether the French government will keep focusing on the National Housing Agency or whether the political context will play out differently: the suspension of the EU ETS directive on aviation will be ending at the end of this year. Unless the EU finds a compromise with developing countries on how to apply the directive, the diplomatic tension could mean a further suspension of the aviation directive and weakened ambition on curbing aviation CO<sub>2</sub> emissions. A way out of this diplomatic deadlock would be to earmark 100 % of the EU ETS revenue from the auctioning of aviation CO<sub>2</sub> permits to climate action in developing countries. In this case, France would earmark the aviation portion of the EU ETS revenue as an additional source of international climate finance for 2014.

### **4.1.3 Case study: Finland**

By Niklas Kaskeala, the Finnish NGO Platform KEPA

#### **Political commitments**

The use of EU ETS revenues has been a widely debated topic in Finland as it is closely related to the issue of Finland's level of Official Development Assistance (ODA). Also, Finland has given an international commitment to raise its level of ODA to 0.7 % of Finland's GNP by the year 2015. As of 2012, Finland has indeed increased its ODA substantially both in volume and as percentage of gross national income. But the current government has however decided that state budget financed ODA will be sustained at the 2012 nominal level in 2013 and 2014, and then decrease by around 60 million EUR in

2015 and by 30 annually in 2016 and 2017<sup>15</sup>. These levels of aid will not allow Finland to reach the 0.7 % target in the near future.

To bridge the estimated 450 million EUR financing gap to reach the 0.7 % ODA/GNI target by 2015, Finland has had to look at alternative sources of revenue. This is where EU ETS revenues enter the picture. The current government's Government Programme states that at the midpoint of its four year term "revenue obtained from the trading of emission allowances will be directed to climate funding and development cooperation. In this context, the objective is to raise development cooperation's share of GNI during this Government's term in office."<sup>16</sup> The Government reaffirmed this plan in its mid-term budget negotiations in March 2013.

The Government did not indicate what proportion of the revenues will be directed to development cooperation and what proportion will go to climate funding or meeting both aims. It has only vaguely stated that EU ETS revenues will be directed towards climate actions with development cooperation.

There is thus a certain ambiguity in the government's plans and political commitments on how to use EU ETS revenues. Furthermore, Finland has so far used ODA to fulfil its climate funding commitments. Climate funding has thus by no means been "new and additional" as was agreed in the COP15 summit in Copenhagen. This practice is likely to continue at least during the current government's term.

### **Possibility of earmarking**

Earmarking EU ETS revenue for climate funding (or ODA) has not really been discussed in Finland. The Ministry of Finance is quite strongly opposed to any such measures. According to officials in the Ministry, earmarking EU ETS revenue would only be possible by creating a separate budget structure. This would in practice mean creating a separate fund that would be outside the state budget.

A separate fund for EU ETS revenues is seen as problematic for several reasons. According to Ministry of Finance officials, the aim in Finland is currently quite the opposite, i.e. to get rid of extra-budgetary funds for transparency and efficiency reasons. Extra-budgetary funds are also seen as undermining the Parliament's budgetary power. It has even been argued that such funds would be unconstitutional.

However, several extra-budgetary funds already exist in some form, for example, pension funds or revenues from the so called Public Broadcasting tax, which are used to fund Finland's national public service broadcasting company.

There is no noticeable political pressure from any major political party for earmarking EU ETS revenues by creating extra-budgetary structures. "Political earmarking", where the Parliament ultimately has the final say, is therefore the only viable option in the current political situation. Environmental and development NGOs are campaigning for EU ETS revenues to be earmarked for climate finance, either through national legislation or by directing them through the Green Climate Fund.

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<sup>15</sup> Finnish Government 22.3.2015

<http://valtioneuvosto.fi/ajankohtaista/tiedotteet/tiedote/en.jsp?oid=380069>

<sup>16</sup> Programme of the Finnish Government,

22.11.2011 <http://valtioneuvosto.fi/hallitus/hallitusohjelma/en.jsp>

#### 4.1.4 Case Study: Romania

By Jiri Jerabek, Greenpeace Central and Eastern Europe

##### Political commitments

In December 2011, the Romanian government agreed a national guideline concerning the details of auctions and distribution of auction revenues, which suggests the following<sup>17</sup>:

The ministry of finance will be responsible for auctioning the allowances.

The revenues from the auction will be redistributed in the following manner:

- 1) 29 % to the state budget;
- 2) 71 % will go to projects submitted by various ministries to (and approved by) the National Administration of the Environment Fund. The project should be in line with the purposes listed in the EU ETS Directive, article 10 paragraph 3

The government will approve project funding, as proposed by the Ministry of Finance and Ministry of Environment and Forests, based on the investment objectives of the projects submitted by the beneficiary ministries to the Environmental Fund.

Separately, the revenues from auctioning certificates from aviation will be directed as follows:

- 1) 70 % towards the Ministry of Transport and Infrastructure, for projects to reduce emissions;
- 2) 30 % towards the Ministry of Environment, also for projects to reduce emissions.

As of April 2013, there were still no projects proposed. An interministerial committee was preparing more detailed guidance about which kind of projects will be eligible for the mechanism. The eligible ministries will be established afterwards, according to the types of projects included in the list – industrial efficiency, transport efficiency, reforestation, etc.

#### 4.1.5 Case study: Czech Republic

By Petr Holub, Chance for Buildings (*Šance pro budovy*)

##### Political commitments

Generally, it can be said that “at least” 50% of EU ETS revenues in the 3rd trading period will be allocated for environmental purposes. The legal basis for this is the law on rules for greenhouse-gas emission allowances trading No. 383/2012 Coll. of 16 November 2012, which came into force as of 1 January 2013.

Paragraphs 5 to 7 of Article 7 give all the necessary guidance on earmarking of auction revenues.\*

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<sup>17</sup> See [http://mmediu.ro/file/OUG\\_115\\_2011.pdf](http://mmediu.ro/file/OUG_115_2011.pdf)

\* Available in Czech at: <http://aplikace.mvcr.cz/sbirka-zakonu/ViewFile.aspx?type=c&id=6283>

**Para 5**

All revenues from EU ETS auctioning (incl. eventually those from civil aviation) are considered state budget income, but at least 50 % is earmarked for the following purposes:

- additional financing of greenhouse-gas emission reduction,
- industrial innovation,
- energy efficiency of district heating, including construction of new networks,
- energy efficiency in buildings and in industry,
- research and development of resource efficient technologies,
- reducing end-users' energy consumption ,
- adaptation measures,
- fulfilling Czech international obligations for development aid and international climate financing,
- administrative costs of EU ETS and registry of allowances,
- research, development, production and roll-out of appropriate technologies to reduce greenhouse-gas emissions from transportation, mainly civil aviation.

**Para 6**

Distribution of the 50 % revenues is as follows: in 2013 everything goes to the State Environmental Fund (SEF), in 2014 and 2015 65 % (of the 50 %) goes to SEF and 35 % to the Ministry of Industry and Trade (MIT). From 2016 to 2020 this ratio shifts to 60/40.

**Para 7**

If revenues that belong to SEF do not reach at least 8 billion CZK (320 million EUR) between 2013 and 2015, then this threshold will be completed between 2016 and 2018 from the revenues that belong to MIT.

**Possibility of earmarking – Conclusion and current political debate**

The legal background for earmarking the EU ETS auctioning revenues in Czech Republic is strong, though it allows a million possibilities for how to spend the money. Political agreement says that most of the revenues going to SEF will be used for an energy efficiency programme for residential buildings. A small part should also go towards international climate financing, but the amount or proportion has not been specified. The MIT's share of revenues will probably go towards reconstruction of district heating networks and energy efficiency in industry.

All this is underpinned by the European Parliament's decision not to support back-loading, and thus expected revenues are rather low. The Minister of Environment has committed to allocating at least 1.4 billion CZK (55 million EUR) for energy efficiency measures in single family houses. These funds will probably be allocated from other sources. An important debate is over the distribution of EU Funds in the next programming period. The Czech Republic should ensure 520 billion CZK (20+ billion EUR) for the period 2014-2020. That's a far larger source of financing than EU ETS, as estimated in spring 2013.

### **4.1.6 Case study: Hungary**

By István Bart, Hungarian Energy Efficiency Institute, MEHI

#### **(Lack of) Public discussion**

In Hungary, climate change is traditionally very low on the political agenda (we have yet to hear Prime Minister Orbán say a single word on the subject). Climate earmarking was mentioned a few times in the press during 2012, mostly by MEHI, and no statements were made by government representatives. There was no public consultation.

#### **Situation within the government**

Assigned Amount Units (AAU) revenues were in the past used to fund a Green Investment Scheme which provided housing estate renovations. People are used to the idea of receiving money for all sorts of carbon credits, and that these need to be spent on the environment in one way or another. As a result, the issue of spending at least 50 % of auction revenues on climate change turned out to be a non-contentious issue. This rule was added to the legislation implementing the EU ETS Directive without much discussion in the Parliament.

This easy passage was probably also helped by the fact that most politicians and many government officials thought that spending half of auction revenues on climate is a binding rule in the ETS Directive.

#### **2013 Budget**

The 2013 Budget clearly indicates auction revenues on the revenue side, and there is a Green Economy Development Scheme with an appropriation of 17 million EUR. This money presumably comes from the auction revenues, although this was never made clear.

There is no official information on how the Green Economy Development Scheme will be set up, or what the revenue will be spent on, but it is rumoured that they will go towards supporting housing renovation.

## 5 Conclusion<sup>18</sup>

It is up to each EU Member State to decide on the use of its EU ETS revenues. However, within the seven countries described above, the EU ETS revenues will partially be spent as recommended in the EU ETS directive (at least 50 %). Also a “kind of political earmarking” could be detected within all seven Member States, for example in France by enshrining the use of the EU ETS revenues in their 2013 finance bill. Therefore, one can assume that – at least within these seven European countries – there actually has been an “appetite for earmarking the EU ETS revenues” for climate-related purposes. But it has to be taken into account that in some countries, like in Poland, the final decision in this regard is still under discussion due to the uncertain EU ETS revenue expectations. Finally, the case studies show that there are many different ways the revenues can be used for international or national climate finance.

This uncertainty in terms of the EU ETS revenue expectation is a particularly serious political issue in Germany. It cannot be guaranteed that the EKF will be maintained after the parliamentary elections in autumn 2013, since the separate budget structure is strongly criticised by the opposition parties – the Greens and the social democrats – mainly due to the uncertain EU ETS revenues. Nevertheless, within the EKF, the following reasonable approaches are fulfilled:

1. earmarking according to the polluter-pays-principle;
2. the transparency of the use of the ETS revenues; and
3. the signal effect for the international climate negotiations.

Therefore, after the parliamentary election, the new German government should consider continuing the EKF. This should be combined with the necessary improvements to the EKF in order to establish a long-lasting budget structure for national and international climate financing. The EU commission will most likely present not later than spring 2014 a white book regarding climate and energy targets for 2030 as well as related instruments like ETS. The decision could come in 2015/16 and starting from this point, the revenue could be higher and more stable.

One additional approach could be to enlarge the revenue side in direction of the polluter-pays-principle (e.g. by using the revenues of the ticket tax on aviation tickets).

It can be assumed that the uncertainty of the EU ETS revenues is a burden for all other EU Member States. The country case studies set out above show that the allocation of the EU ETS revenues is mainly focused on the national side (e.g. within the building sector like in France). However, Finland is an interesting exception, since it uses all of its EU ETS revenues for climate action within development cooperation (and as a contribution to its ODA). In general, using an innovative finance source for national and international climate financing would be appropriate within the EU, if such a source could be established in a reliable way. The financial needs for both domestic transformation and climate and adaptation action in developing countries are significant. But at present it is not clear if the EU ETS revenues will play an important role to finance climate action, either nationally or internationally.

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<sup>18</sup> It is worth mentioning that the conclusions are a reflection only of the lead author (A. Esch, Germanwatch).

The following months will show if there is the political will to reactivate the EU ETS as an emission reduction and financing instrument. Our few country case studies underline that these EU Member States are willing to use the EU ETS revenues in line with the EU ETS-directive. The plans are prepared – and now the right decision for repairing the EU ETS should be taken.



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For further information, please contact one of our offices

### **Germanwatch – Berlin Office**

Schiffbauerdamm 15  
10117 Berlin, Germany  
Ph.: +49 (0) 30 - 28 88 356-0  
Fax: +49 (0) 30 - 28 88 356-1

### **Germanwatch – Bonn Office**

Dr. Werner-Schuster-Haus  
Kaiserstraße 201  
53113 Bonn, Germany  
Ph.: +49 (0) 228 - 60492-0  
Fax: +49 (0) 228 - 60492-19

E-mail: [info@germanwatch.org](mailto:info@germanwatch.org)

or visit our website:

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