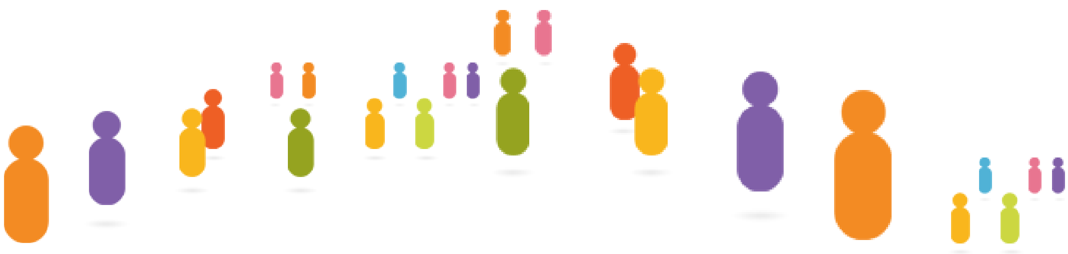
The European Consumer Organisation

The Consumer Voice in Europe

Well-funded, well-designed and well-disbursed: How to develop a Social Climate Fund that works for people

BEUC position paper



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Why it matters to consumers

The proposed extension of the EU Emissions Trading System (EU ETS) to road transport and buildings could translate into higher mobility and heating costs for consumers without helping them switch to cleaner alternatives. It is crucial to design a system that mitigates its adverse impact, especially on less affluent consumers.

Summary

The Social Climate Fund could be a powerful tool to protect consumers against rising energy prices and help them transition to greener lifestyles. However, some important changes should be made to the current proposal:

1) Decouple the SCF from the ETS extension – the SCF should be implemented even if the ETS extension does not go ahead.
2) All funding from the proposed ETS extension should flow back to consumers via the SCF, and should not go to industry.
3) The Fund should be used to provide direct income support to consumers, as well as funding green investments, schemes and infrastructure projects with a proven benefit to consumers, particularly those at the lower end of the income scale.
4) The principle of additionality should be upheld, meaning SCF spending should generate new projects and not simply replace other MS budgetary spending.
5) Provided the ETS extension goes ahead, consumers should be given a longer adaptation window between the rollout of the SCF and the ETS extension.
6) A "price corridor" should be considered for carbon pricing, and the Fund should be extended for as long as it proves valuable
7) Other legislative instruments should be used in conjunction with the SCF to improve the situation for European consumers, particularly those at risk of energy poverty.

Introduction

Europe finds itself at the beginning of an energy transition that needs acceleration to avert climate disaster, while also being in the midst of a more immediate energy crisis. With approximately 34 million Europeans unable to adequately warm their homes, and a very well-documented surge in energy prices across Europe further putting the pinch on consumers, energy poverty and consumer protection has come to the forefront of the conversation in Europe.

Amidst this conversation comes the European Commission's Fit For 55 package; a plan to transition the European Union off fossil fuels, into a greener future. As part of the many good proposals included in the Fit for 55 package released by the European Commission in summer 2021, one of the more controversial aspects was the proposed extension of the Emissions Trading Scheme (ETS) to buildings and road transport – essentially, new taxes via fuel and heating, designed to encourage consumers to shift towards sustainable energy and mobility, away from a dependence on fossil fuels.

Before the publication of the Fit for 55 package, BEUC had highlighted its concerns around the extension of the ETS to buildings and transport. While we acknowledged that environmental taxation and carbon pricing have an important role to play in the transition, we have also warned that imposing carbon pricing without strong compensatory measures could create social hardship and strengthen inequalities, without contributing to the advancement of the environmental/climate agenda. This is especially the case in transport and heating where consumer demand is rather 'inelastic' to price signals for low and middle-income consumers in particular. This is because the costs of renovating your home, switching from an oil boiler to a renewable heating system or from a diesel to an electric car are often so high that consumers are at risk of being locked into their current lifestyles without being able to switch to cleaner alternatives.

In the Fit for 55 package, the European Commission has acknowledged the challenge of the proposed ETS extension in terms of distributional impact and the risk that increased carbon pricing could create social hardship. To mitigate the costs for people and to avoid social hardship, the Commission has proposed the creation of a 'Social Climate Fund' (SCF), which would be funded by the revenues of the extended ETS, and which would aim at financing a series of compensation measures for consumers which would: a) compensate them for the higher costs and/or; b) help them to access more sustainable alternatives such as greener heating appliances or modes of transport.

While the Commission's initial proposal to create an SCF is a laudable idea, several improvements should be made to ensure that the ETS extension does not harm European households, especially lower-income ones, and that the new fund really helps people to engage in the transition.

1. Decoupling the SCF from the ETS

1.1 The shortcomings of the current proposal:

As proposed currently, the existence of the Social Climate Fund depends entirely on the entry into force of the ETS extension to transport and buildings. As it stands, if this proposed ETS extension were to fail, so too would the proposal for the SCF. We believe the idea to create an EU-wide fund to mitigate the impact of the transition for consumers and help them switch to more sustainable lifestyles is a good one.

Independently of whether or not the ETS extension will be adopted, consumers will undoubtedly face barriers in moving to more sustainable energy and mobility systems. These financial hurdles are well documented, from the higher up-front costs of electric cars to the costs of housing renovation projects. The SCF, coupled with other measures, can help in overcoming these hurdles.

1.2. Our recommendation:

The SCF is a good initiative on its own merits, and it should be implemented irrespective of the fate of the ETS extension to road transport and buildings.

The SCF could be funded by earmarking a share of the revenues generated under the current ETS, as is the case with the Innovation and Modernisation Funds. Partial financing of the SCF through ETS1 could apply even if ETS2 goes ahead, as it would maximise the impact of the redistribution measures.

It is also an issue of fairness: it is sometimes forgotten that households already bear part of the costs of the general ETS via their electricity bills. For instance, it is estimated that around one quarter of the recent energy prices surge is attributable to the rising prices of allowances under the currently applicable ETS. So even if the carbon market only contributes a minor share of the energy price increases, consumers do already feel the effects of the EU carbon market on their bills. Hence, it would be fair to dedicate a share of the ETS1 revenues to financing the mitigating measures for consumers.

2. All of the revenues from the ETS extension should be used to help households in the transition

2.1 The shortcomings of the current proposal:

Under the current proposal, Member States would collect the revenues generated by the increased carbon pricing and partly transfer them to the European Union's budget. Of these revenues, one quarter would be used to set up the SCF.

To access the funds earmarked for the SCF, Member States must submit Social Climate Plans which resemble the top-down approach of the Resilience and Recovery Facility, to be submitted along with their updated National Energy and Climate Plans. The payments to Member States under the Fund would be made upon completion of the milestones and targets indicated in the Social Climate Plan.

As it stands, the Commission's proposal offers two ways in which the funding can be used: firstly, Member States have the *option* to provide temporary direct income support to vulnerable consumers. Secondly, Member States must *as an obligation* include national projects that increase the uptake of zero-/low-emission mobility and transport, as well as financing energy efficiency improvements in buildings, the decarbonisation of heating/cooling, and the uptake of renewable energy technologies. As with the income support, these projects are supposed to target low-income and vulnerable consumers.

The Commission estimates that the SCF is projected to stand as a €72.2bn fund to be dispersed among Member States between 2025 and 2032.

Regarding the rest of the ETS extension revenues, 150 million allowances (estimated to be worth €7.5bn) are to be added to the Innovation Fund, another EU fund designated to support industry innovation in low carbon technology. The rest of the revenues would be shared among the Member States which would be free to spend it the way they see fit, as long as it is in line with the guidelines in Article 10 of the ETS Directive. Yet, the guidelines covered by this article are broad, at times vague and can be used to finance projects such as carbon capture and storage, research into clean technologies and forestry sequestration.

This is an important flaw of the current proposal: much of the foreseen expenditure generated by ETS revenues would not be consumer focused. While it can reasonably be expected that the vast majority of the ETS extension would be paid for by consumers, only the revenues dedicated to the SCF would return to them as benefits. Many of the foreseen measures, for instance through the Innovation Fund or through the spendings under Art 10 of the ETS Directive, could end up cross-financing industry without benefitting consumers or financing projects that wouldn't have any beneficial impact on individual consumers.

2.2 Our recommendation:

It is important that **cross-subsidisation be avoided**, meaning funding generated by consumers should flow back to consumers and not finance industry in their innovation projects, unless such projects have a clear and immediate benefit for consumers, such as making green choices more affordable. This is a central condition for the political acceptability of any carbon pricing measure, and would respect the purpose of the ETS, which is not simply to generate revenues for Member States, but specifically to encourage consumers to make the shift away from fossil fuels. Instead of 25% of the ETS extension going to the SCF, we believe **all funding from the ETS should flow back to consumers**.

The impact of the current financial proposal is not ambitious enough to have a meaningful impact on consumers and to fund the proposed projects. Redirecting all ETS extension revenues towards consumers would ensure a much more ambitious and better-funded SCF, whose impact would be far more significant for consumers than that of the original proposal.

In line with this principle, **no revenues from the ETS extension should flow to the Innovation Fund or to measures under Article 10**. As the costs of the ETS extension will very likely be fully passed on to consumers, it is not appropriate that money be taken from consumers to pay for industry to modernise or to replace the general budget for climate action. As a question of social fairness, such measures should be financed by industry, or by other taxation measures, not by consumers at the European level.

3. What should the SCF be used for?

3.1. The shortcomings of the current proposal:

As mentioned above, Article 3 of the current proposal lists the measures which are eligible for funding from the Social Climate Fund, with direct consumer support in the form of lump sum payments being optional, and other types of green investments being mandatory.

From a consumer perspective, it is still essential that the Fund will include a form of direct consumer compensation. This is because the impact of increased carbon pricing will be felt immediately by consumers, while the benefits of the green investments will only materialise at a later stage. As soon as the extended ETS will enter into force, consumers will notice the difference when paying a higher price to refuel their car or when paying their heating bills. However, they will only see the benefits of housing insulation programs or the construction of sustainable mobility infrastructure possibly up to several years later. To avoid this mismatch in timing, we believe **direct consumer support for vulnerable consumers should be a mandatory part of the proposal**, and that green investments should come as a complement.

3.2. Our recommendation:

We believe it is crucial that all consumers should be supported in the transition, with special attention given to the energy poor. In order to do this, we believe **Member States should consider two streams of disbursement:**

- **Direct payments to consumers should play a key role in the Fund.** Direct income support is the best way to protect consumers from the rise in energy and fuel costs, providing immediate relief from price rises, which is particularly important for those living in energy poverty,[1] but also for middle-class consumers who can be considered at risk of energy poverty.

- In order to encourage longer-term changes**, funds should also be used for green investments that target consumers, with an emphasis on low-income and vulnerable consumers,** such as housing renovation programs, development of cycling infrastructure, improvements to public transport, and switching to renewable heating devices. For further information on this type of funding and how it can be best utilised, see the box below.

[1] The EU-funded H2020 "STEP" project conducted surveys in partner countries to drive towards a common definition of energy poverty

Practical examples of how the SCF could be used to support the renovation of buildings and the uptake of renewable energy

One of the biggest hurdles for consumers wishing to switch to sustainable energy is the costs, which are often significant. To tackle the cost barrier, governments and local authorities can set up schemes to which consumers can apply, for example, to replace their fossil fuel boiler with a heat pump, or to make energy efficiency improvements to their home. Such schemes could be funded anywhere up to 100%. In many cases, however, such programs rely on the consumer to foot the bill, and they are later reimbursed. This would overlook the fact that many consumers cannot afford the upfront costs – here is where innovative financial instruments can come into play.

Financial instruments (FIs) can be used for the benefit of low-income households. The SCF can be used either to directly fund such instruments, or to fund their operational costs (management and workforce). Such instruments can also act as leverage, allowing for private financing to step in at an affordable cost.

To illustrate how the SCF could be supportive of inclusive FIs, let us consider the implementation of an on-bill scheme (OBS). OBS are micro-loans that fund energy efficiency measures – while the energy supplier or a third-party financer pays the up-front costs, the repayments are folded into the consumer's monthly energy bills.

SCF funding could act as a grant to reduce the monthly repayments of households and/or to fund a loan-loss reserve that steps in, in case of default on the repayment of the micro-loan. Providing such security to low-income households facilitates their eligibility and access to the OBS in the first place as it lowers the financial risks for money lenders funding the OBS. Consequently, a ban on disconnection that protects consumers can be introduced, as repayments are secured.

Special earmarking of the Fund should also be made **for less affluent consumers, with a focus on the energy poor**. Low-income consumers already spend a disproportionate amount of their savings on energy and fuel costs compared to wealthier consumers. In fact, analysis has shown that the average rise in household expenditures due to carbon pricing is 3.5 times higher for low-income households than high-income households[1], highlighting the importance of protecting such consumers in the transition.

Meanwhile, while there may be a place in the Fund for **infrastructure projects**, these should be **thoroughly assessed** on a case-by-case basis to **ensure they benefit consumers**, for whom the Fund is targeted, and help them switch to more sustainable lifestyles. As mentioned previously, it should also be assessed how the impact of the **ETS extension might lead previously middle-class consumers to become economically vulnerable**, and thus newly eligible to benefit from such projects. Projects targeting low- or zero-emission mobility could be particularly suitable, such as an investment in public transport that increases frequency of regional trains and allows consumers to forego using their car to commute.

However, investments in infrastructure do not only necessarily concern physical infrastructure. It can also mean investing in the enabling conditions to facilitate peoples' engagement in the transition. One-stop-shops, where people can find expertise and concrete support to define their housing renovation projects, are an example of this.

It will also be important to ensure **sound governance** of the disbursement of funds and financing of programs. To ensure the best use of funds to benefit consumers, social partners and civil society organisations should be consulted. One possibility would be to create an ad hoc structure responsible for managing all national funding received through the SCF, as proposed by our Austrian member AK Wien with their 'Energy and Climate Aid Fund'[2]. This body could lead coordination of project implementation, networking of relevant stakeholders, and act as a central contact point for the European Commission.

It is also crucial, particularly in relation to infrastructure projects, that the **principle of additionality be respected**, as per Article 12 of the proposal. This means funding to Member States should not replace or substitute Union or national budgetary expenditure but lead to **additional support measures or investments** that would not have been otherwise foreseen by the Member State without access to the SCF.

In the weeds: How to ensure the additionality principle in the ETS proposal

While the additionality principle is respected in Article 12 of the SCF proposal, it is lacking in the ETS proposal itself. This means that Member States could use revenues from the ETS to finance social measures set up in the past. To overcome this, European lawmakers should delete subparagraph 3 of the new Article 30d (5)(b), which deems Member States to have fulfilled their social obligations under the ETS, as long as they have in place financial support policies equivalent to the revenues generated from the auctioning of allowances.

Why are we asking for this? Because through the ETS expansion, consumers will experience an additional financial burden, meaning the pre-existing level of financial support would no longer be adequate to compensate the additional financial burden of carbon pricing through the EU ETS.

[2] https://www.akeuropa.eu/sites/default/files/2021-10/Fit_for_55_I_Pricing_Greenhouse_Gas_Emissions_4.pdf

4. Complementary protections for consumers

4.1. The shortcomings of the current proposal:

As mentioned above, BEUC has considerable reservations about the extension of ETS to road transport and buildings. Even with a well-designed SCF helping to soften the impact on consumers (and, hopefully, helping them to engage more actively in the transition), we remain of the opinion that introducing carbon pricing through a market demand vs. offer system can be risky.

One key concern is that of sudden and severe price variations in the carbon market, such as the one of autumn-winter 2021, with the price of the ETS allowance having plummeted during the COVID-19 pandemic to below €20 per ton, and later rising to over €80 per ton in December 2021. In cases of such sudden variations, we fear that the SCF might not be adaptable enough, or indeed move quick enough, to shield consumers against increasing prices.

4.2. Our recommendation:

Several measures could be envisaged to mitigate the risks of increased carbon pricing. We could, for instance, envisage a **price corridor**, similar to a price cap, which would include both a minimum and maximum price of allowances. This would ensure visibility in the system and would make sure that, in case of unexpected tensions on the market, prices would not suddenly skyrocket, putting consumers at risk of financial difficulties.

Another key concern in the SCF for BEUC is the issue of **timing**. While under the original ETS, industry have been receiving free allowances for many years, the SCF proposal allows just a single year of adjustment between the roll-out of the SCF and the introduction of the new ETS levies. Through the CLEAR-X project, BEUC and its partners are demonstrating that in order to switch to renewables, consumers need time to conduct research, access funding options and save money to be able to invest. In most cases, one year will not be sufficient to conduct this process, particularly for low-income and vulnerable consumers. Taking inspiration from the original ETS, **consumers should be provided with a longer adaptation window, and a system of free allowances that gives them a reasonable adjustment period**. Along with this, we believe **lump sum payments to consumers should be prioritised in the Fund's first years,** to enable such purchases.

BEUC also highlights its concern that the extension of the Fund is only until 2032, when we know already that supporting mobility- and energy-poor households in the transition will be necessary far beyond the start of the next decade. We would therefore suggest that **the Fund be made available as a support instrument as long as deemed necessary, and certainly beyond 2032**.

5. The need for strong complementary sector-specific policies and for a broader clean-up of misleading price signals

5.1. The current shortcomings:

Currently, electricity bills contain a lot of taxes and levies which are unrelated to energy (such as charges for public television or road maintenance in certain countries). The high share of taxes and levies in the electricity bill artificially make electricity more expensive than natural gas. This is one of the factors holding consumers back from switching to renewable heating systems and electric cars. In addition, all households, no matter their income, pay the same percentage in taxes and levies, which makes this practice also socially unfair. Low-income households indeed pay proportionately more, because they live in less energy efficient homes and use less energy efficient appliances. Finally, in many Member States, industry is paying a lower share of energy taxes and levies than individual consumers. The energy transition is a societal task to which all actors should contribute equally.

Beyond price signals, there are many non-financial barriers which prevent consumers from making the switch to renewable heating and sustainable transport solutions.

5.2. Our recommendation:

A reform of the current energy taxation is urgently needed to implement the 'polluter pays' principle and allow for the right price signals. The proposal for a revised Energy Taxation Directive is a welcome step in the right direction as it abolishes the different levels of taxation between business and non-business users and it foresees a ranking of minimum taxation levels reflecting the polluter pays principle. We recommend Member States take a constructive stance towards this proposal and ensure an ambitious implementation at national level. Comprehensive reforms on non-energy related taxes and levies in energy bills should complement the reform of the Energy Taxation Directive.

In addition to price signals, the Fit for 55 package provides the opportunity to overcome many non-financial barriers hampering the energy transition. In dealing with energy poverty, the opportunity should not be missed to utilise other legislation, such as the Energy Efficiency Directive (EED). BEUC's long-standing position is that energy poverty should be tackled as an issue of energy use and efficiency, and not simply through a social lens, which leads to wasteful social spending without tackling the root causes of energy inefficiency. **The EED should ensure ring-fencing of energy savings to be made among the energy poor** (as currently proposed in Article 8), **as well as ensuring energy efficiency measures among the same group** (currently referred to in Article 9 as a recommendation rather than an obligation).

The EED can also be used to greatly expand consumer rights in district heating, to bring them into line with the rights of electricity consumers. Meanwhile the EED, as well as the EPBD, should also be used to expand the role of one-stop shops, and generally provide more sustainable housing for consumers. Adequate measures should also be put in place to promote more ambitious Co2 targets for cars, and to promote heat pumps or other climate-friendly heating systems as the best heating option for many consumers.

END

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