Europe in motion

Ending all public financial support for fossil fuels

Briefing paper
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Introduction

With the adoption of the Paris Agreement on climate change in 2015, followed by its entry into force in 2016, the EU and its Member States have demonstrated their ambition to limit the increase in global average temperature to well below 2°C degrees, and to pursue efforts to limit global temperature rise to an even more ambitious 1.5°C target.

An important objective of the Paris Agreement stipulates that financial flows need to be made *"consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."*[1]

The Paris Agreement requires a major overhaul of not just climate and energy policies in the EU, but also financial policies and investments to ensure a fair and ambitious shift towards renewable energy, energy savings and climate resilience. **Importantly, in consequence it requires the EU and its Member States to immediately end all public financial support for fossil fuels and to address the EU policies, mechanisms and instruments that directly and indirectly finance fossil fuels.**

Following the publication of the report 'Phase-out 2020: Monitoring Europe's fossil fuel subsidy phase out', this briefing provides a set of recommendations to the EU on how it can better align its public financing – including some of its key policies, instruments and institutions – with the long-term objectives of the Paris Agreement.[2]

The focus of the policy recommendations in this briefing centres on EU funds and EU policies, financial instruments and the European investment and development banks, all of which directly or indirectly support fossil fuels, both in the EU and outside of it:

- **The Multiannual Financial Framework**
  The Connecting Europe Facility
  The European Regional Development and Cohesion Funds
- **European public banks and financial instruments**
  The European Investment Bank
  The European Bank for Reconstruction and Development
  The European Fund for Strategic Investments
- **Systemic support for fossil fuels through EU policies**
  The EU Emissions Trading Scheme
  EU State Aid and Capacity Mechanisms

Building on the report findings, we provide a set of **policy recommendations for the following areas:**

1. More effective EU-wide governance, transparency and reporting of public support for fossil fuels and phase out plans
2. Making the EU budget fossil fuel-free
3. Ending fossil fuel support from European banks and financial instruments
4. Fixing the systemic flaws that indirectly support fossil fuels

[1] http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf

[2] Climate Action Network (CAN) Europe together with Overseas Development Institute, CEE Bankwatch, CounterBalance and Friends of the Earth Europe, (http://www.caneurope.org/publications/blogs/1471-report-phase-out-2020-monitoring-europe-s-fossil-fuel-subsidies)

More effective EU-wide governance, transparency and reporting of fossil fuel subsidies

Despite the recognition that fossil fuel subsidies remain a problematic barrier to the EU's clean energy transition, there has been limited action to systematically address them across the EU and its Member States. The EU has not put in place mechanisms to document the full extent of fossil fuel subsidies, and therefore is not holding itself properly to account in achieving pledges to phase out fossil fuel subsidies. These shortcomings in EU governance and transparency need to be addressed in order to achieve full phase out of fossil fuel subsidies.

Recommendations for EU-wide governance of fossil fuel subsidies phase out:

- The EU to develop and roll out an action plan to phase out fossil fuel subsidies in Europe;
- The European Commission to implement its plan to establish regular monitoring of fossil fuel subsidies in the EU and of the progress on the phasing out plans, including EU policies such as the EU ETS and State aid regulations;
- Include fossil fuel subsidy phase out in the EU's Energy Union Governance framework: specifically, require Member States to use their National Energy and Climate Plans (NECPs) to increase transparency of fossil fuel subsidies through consistent monitoring and reporting on fossil fuel subsidies and progress in phasing them out. This should include a requirement to describe the policies, timelines and measures planned by Member States;
- Member States to include reporting on investments in and finance for fossil fuels by state-owned enterprises and majority publicly owned financial institutions;
- The European Commission to fulfil its commitment to carry out a REFIT evaluation of the EU framework for energy taxation in order to define possible next steps, also in the context of the efforts to remove fossil fuel subsidies.

Making the EU budget fossil fuel-free

We have found that sectors substantially supported by EU funds are major greenhouse gas emitters in Europe. Fossil fuels still receive subsidies from the EU budget which has allocated in total over €2 billion in funding for gas infrastructure from 2014 to 2020, demonstrating that competing and incoherent priorities are undermining the EU's long-term climate objectives. In particular, the EU budget has provided favourable support to gas infrastructure which flies in the face of any effective decarbonisation pathway that the EU aspires to pursue.

The EU budget can significantly contribute to realising the EU's long-term decarbonisation but it needs to take more ambitious steps if it is to achieve such an objective.

Recommendations on aligning the EU budget and its funds with the Paris Agreement:

- Fully exclude support for fossil fuels in the post-2020 EU budget and all of its funds, including through research and innovation programmes;
- No allocation of funding for gas or gas infrastructure through the post-2020 Connecting Europe Facility (CEF), and phase out of gas financing in the years 2018 to 2020;
- Strengthen the role of the EU budget in achieving Paris Agreement objectives and in ensuring the transition towards a zero-carbon economy;

- Align conditions for EU funding with 2030 and 2050 zero carbon climate strategies and investment plans, including future-proofing any funding for strategies that will need to be updated and improved in order to meet the long-term objectives of the Paris Agreement;
- Adequately assess how the deployment of EU funds can meet the full potential of renewable energy and energy efficiency through projects in Member States, including transmission, storage and transport of energy;
- End support for high carbon projects notably in the transport sector (air and road), with tight exemptions for small-scale local roads in CEE countries only;
- Introduce financial incentives for higher targets in Member States' National Energy and Climate Plans for 2030 to better align EU funding with investment needs in line with the objectives of the Paris Agreement;
- Be subject to regular checks-ups and reporting on how it is contributing to the EU's decarbonisation goal;
- Implement a more transparent and robust assessment of project proposals submitted for funding, a Climate Impact Assessment, and which fit with low energy consumption demands in the future;
- Increase the specific climate-related spending target to 40% of the EU budget;
- Integrate the Energy Efficiency First principle as a guiding criterion for plans and programmes. This should better ensure that countries which submit project proposals are prioritising energy efficiency first and foremost.

Ending support from European banks and financial instruments to fossil fuels

Some promising commitments and first steps were made by European public investment banks to curb coal financing and fund climate action and clean energy projects. However, a substantial level of support from the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) is still going to fossil fuels.[3]

The EU's flagship financial instrument, the European Fund for Strategic Investments (EFSI) shows similar trends in funding. While the EU claims that the Fund contributes to the EU's climate and energy objectives, over 15% of energy projects funded by the EFSI have been fossil fuel projects – in particular gas and gas infrastructure projects.[4] This comes at a time of decreasing EU gas consumption and projected reduced gas demand in the medium to long term future, and therefore it creates a high risk of sub-optimal investments and stranded assets. A sound analysis of the climate impact of EFSI projects also needs to take place so that high-carbon projects detrimental to reaching EU climate objectives cannot be supported by it.

In 2018, the EIB and EBRD will undertake revisions of their energy policies. We recommend that these revisions **rule out all direct lending to fossil fuel projects and include a time-bound plan to phase out**

[3] The EIB supported fossil fuel projects in EU Member States worth €5.3 billion from 2014 to 2016, and one coal and five gas projects worth €976 million in countries outside the EU. The EBRD funded six fossil fuel projects worth €209 million & contribution to 31 coal, oil and gas projects in the Caucasus, Central Asia and the Middle East, worth €2.3 billion for the same period.

[4] 'EFSI 2.0: Make it climate proof, additional and transparent'; http://www.caneurope.org/docman/fossil-fuel-subsidies-1/2971-efsi-2-0-make-it-climate-proof-additional-and-transparent/file

funding for projects that contribute to downstream consumption of fossil fuels, such as road and air transport.

The EFSI will continue to provide investment support for energy across the EU up to 2020, and likely beyond. **With a view to stimulating truly sustainable development, gas infrastructure investments need to cease immediately.**

Recommendations for the European Investment Bank:

- Raise the percentage of climate specific spending from 25% to at least 50% by 2030 (including for the Juncker Investment Plan through the EFSI), following the adoption of the EU 2030 climate and energy targets;
- In its 2018 energy policy revision, the EIB should explicitly commit to end any support to fossil fuel extraction projects and any kind of fossil fuel energy projects;
- Stop corporate level investments in coal-heavy state-owned utilities, especially those expanding coal mines and building new coal power plants;
- Within Europe end support for high carbon transport (air and road), with tight exemptions for local roads in Central Eastern European (CEE) countries;
- Develop country-specific approaches in support of national climate action plans in line with the Paris Agreement and the new EU roadmap for a competitive, low carbon economy;
- Revise the bank's climate policy with a view to including its portfolio's absolute emissions reductions, in line with limiting global temperature increase to 1.5°C;
- Develop new methodologies to assess the alignment of the bank's portfolio with the Paris Agreement, particularly for high carbon sectors;
- Revise its methods for measuring greenhouse gas emission estimations of large projects so that the bank not only accounts for emissions directly caused by the infrastructure in question, but also accounts for so-called Scope 3 indirect emissions - those which arise later as a result of its use.

Recommendations for the European Bank for Reconstruction and Development:

- Use the 2018 Mining Strategy and Energy Operations Policy revisions to commit to ending support for all fossil fuel projects in the extractive and power sectors;
- Develop a Climate Strategy that will guide its Green Economy Transition approach and spell out steps for supporting the phase out of support for fossil fuels, including technical assistance and policy dialogue, in its countries of operations;
- Apply the 40% Green Economy Transition target by 2020 to country and regional portfolios, and increase efforts to phase out fossil fuel investments outside of the EU, where investments in coal, oil and gas are much greater than those in the EU;
- Stop corporate level investments in coal-heavy state-owned utilities, especially those expanding coal mines and building new coal power plants;
- Develop new methodologies to assess the alignment of the EBRD's portfolio with the Paris Agreement, particularly for high carbon sectors;
- Revise its methods for measuring greenhouse gas emission estimations for its projects so that the EBRD not only accounts for emissions directly caused by the infrastructure in question, but

also accounts for so-called Scope 3 indirect emissions - those which arise later as a result of its use.

Recommendations for the European Fund for Strategic Investments:

- Exclude all support to fossil fuel projects, including fossil fuel infrastructure;
- Ensure that the Innovation and Infrastructure Window (IIW) becomes climate proof;
- Set a threshold of at least 50% of its financing under the IIW for climate action projects; in particular, EFSI should also earmark funds for energy efficiency;
- In the transport sector, end support to air transport and new motorways and ensure that it supports projects aiming at the decarbonization of the transport sector;
- Collaborate with the EIB and European Commission to ensure that the EFSI becomes a catalyst for sustainable investments and climate action, by providing additionality to the EIB's standard operations in these areas;
- A sound analysis of the climate impact of EFSI projects needs to take place so that high-carbon projects detrimental to reaching EU climate objectives cannot be supported under it.

Fixing the systemic flaws that indirectly support fossil fuels

The EU Emissions Trading Scheme:

The EU Emissions Trading Scheme (ETS) has shown itself incapable of adapting to the reality of the carbon market and plays no role in driving the low-carbon transition. Moreover some of the resources generated by the ETS are working against the energy transition, and are instead supporting dirty fossil fuels: ETS funding and free pollution permits are playing a role in prolonging the life of coal power plants and other fossil fuel usage. Adding up the total market value of estimated free allowances and exemptions under the ETS from 2008 to 2030, fossil fuel subsidies under the ETS amount to almost €496 billion.

Recommendations for the ETS to end its indirect support to fossil fuels:

- Free pollution permits need to be phased out and auctioning must become the only way to allocate ETS emission allowances. Handing out free allowances and compensating companies for indirect costs should not be allowed under the ETS.
- It is imperative that the ETS and its related financial flows adhere to the broad principle that polluters should pay and that no financial support should be given to fossil fuel based, nuclear energy production, or biomass co-firing.
- This means that article 10c derogation and other ETS related funding mechanisms should exclude any fossil fuels investments (coal in particular) or be abolished, as they undermine the EU's long-term decarbonisation objective.

State aid and capacity mechanisms

Key concerns persist regarding the use of State aid to prolong the life of fossil fuels in EU Member States. There are a growing number of examples where the EC has decided to allow State aid for governments supporting fossil fuel-related energy projects.[5]

[5] There is an explicit Council Decision (787/2010/EU), adopted in 2010, which allows some 'closure aid' to coal mining. However, mining aid under Council Decision 787/2010 is not straightforward as it is support (1) for the continued operation of mines, but only until a given closure date no later than 2018 and/or (2) 'exceptional costs' of mine closure, including for example the retraining of workers and rehabilitation of mining sites.

A specific type of State aid – the capacity mechanism – has become a tool commonly used by Member States to remunerate the availability of electricity generation to avoid black-outs and ensure that electricity supply permanently meets demand. Current widespread introduction of capacity mechanisms runs counter to the EU's decarbonisation objectives, distorts price and investment signals and favours fossil fuels and nuclear generation to the detriment of renewable energy sources, energy efficiency and demand side management.

Recommendations for addressing State aid as a subsidy to fossil fuels:

- Member States should immediately stop giving public money to fossil fuel projects. New EU rules for State aid need to be adopted which fully exclude the provision of State aid that allows for subsidizing fossil fuel production and consumption;
- The European Commission needs to be stricter in its assessments of the measures that the Member States send in;
- Improve transparency of State aid decisions to allow for NGOs and other actors to follow and to challenge them in the public interest if necessary;
- State aid support must reach affected workers and communities directly; it should not be compensation to fossil fuel companies' loss in profits. Governments should invest in a just transition fund earmarked to support the workers affected and help them transition to jobs in other sectors.

Recommendations on Capacity Mechanisms:

- The EU and its Member States should take a much more critical approach to the use of capacity mechanisms, not just narrowly focusing on implications for competition, but also on long-term decarbonisation objectives. EU governments need to prioritise low-carbon options for ensuring the reliability of the power system, in order to eliminate any support for fossil fuels and coal energy in the first place;
- Ensure that capacity mechanisms are the last resort option by establishing clear and compulsory criteria requiring Member States to provide adequate evidence of the need to intervene and address power insufficiencies. Any decision regarding the introduction of capacity mechanisms must be based on regional resource adequacy assessments;
- All capacity markets should be fully open to renewable energy capacity, interconnectors, demand response and storage. Mechanisms should not prevent carbon intensive and inflexible power plants from leaving the market, and in cases where capacity mechanisms are used, they should be reversible, and interfere as little as possible with the market;
- Any introduced capacity mechanism should be granted for a limited period of time and under the condition that Member States will provide and implement a plan to address its resource inadequacy, eliminating the need for future capacity mechanisms;
- The approach adopted to deliver reliability should not lead to adverse consequences for investments in renewable energy.

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Full Report: Phase-out 2020: Monitoring Europe's fossil fuel subsidy phase-out found here
Executive Summary found here
EU Brief found here