# Comments on the proposal to amend the Recovery and Resilience Facility regulation in the context of REpowerEU

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## Key recommendations

The present briefing assesses key components of the European Commission's proposal to amend the RRF regulation in the context of the RepowerEU strategy. Our overarching recommendations are the following:

- the financial leg of RepowerEU is clearly insufficient for delivering more ambitious targets to accelerate the phase out the EU's dependence on imported fossil fuels: in the medium term, raising the EU budget is necessary to deliver ambitious RepowerEU targets;
- the proposal to mobilise the Market Stability Reserve of the ETS (Article 4 and 5 of the proposed amendment) should be entirely scrapped and replaced by other viable means of income generation, which we outline;
- the proposal to waive Do No Significant Harm (DNSH) requirements for "security of supply" related investments (article 21c par. 2.4. of the proposed amendment) should equally be entirely scrapped, as it will lead to an increase of fossil fuel investments across Member States;
- the reopening of the RRF regulation should be harnessed to improve several pitfalls of the original RRF regulation, notably concerning public participation and monitoring (articles 1 par. 3 & 3 of the proposed amendment) as well as the regional distribution and social dimensions of RRF funds (article 1 par. 1 & annex 1 of the proposed amendment).

## 1. General comments on the financial leg of RepowerEU

Delivering RepowerEU targets implies substantial additional investment needs notably for renewables roll-out, energy efficiency and savings measures, as well as a significant frontloading and acceleration of already planned investments. However, even prior to the war, there was a severe investment gap for delivering EU energy transition and climate targets to 2030: according to some estimations, the entirety of EU funds (including the Next Generation EU package and the MFF 2021-27) could be expected to mobilise approximately €670 billion for climate and energy transition related investments for the period 2021-27, assuming that the funds are well utilised and fully absorbed. This contrasts with public and private investment needs of €2.4 trillion over the same period, to reach a 55% emissions reduction target by 2030.

On top of this pre-existing investment gap, the European Commission estimates that delivering RepowerEU targets implies additional investment needs of €210 billion across the Union up to 2027. It is within this context that the European Commission's proposal to amend the Recovery and Resilience Facility (RRF) regulation needs to be analysed.

While we understand the rationale behind making the RRF the main instrument for delivering RepowerEU targets, the EC's proposal falls short in mobilising sufficient additional finance at the EU level and puts at risk the achievement of key environmental objectives:

- First, out of the €284.4 billion that could theoretically be mobilised via the RRF[1], only €20 billion consist of "fresh" resources, while €264.4 billion consist of a reshuffling of existing budget lines – by mobilising existing cohesion funds and the RRF's loan facility. As such, this proposal fails to address the large investment gap that predated the invasion of Ukraine and RepowerEU. It is in fact arguable that the investment gap (i.e. the gap between EU funds and investment needs for the energy transition and climate targets) is now larger.
- Second, the means to raise these additional resources by mobilising the Market Stability Reserves of the EU Emissions Trading System (ETS) is highly problematic sui generis, risks undermining the functioning of the EU carbon market and will likely be offset by a corresponding reduction of resources from ETS revenues in Member States (see our assessment of the MSR proposal below).
- Third, the overwhelming majority of resources mobilised through the RRF for RepowerEU consist of loans, which are accounted as national public debts. There are question marks on whether Member States have appetite to apply for additional loans, and the pool of additional loans available to Member States will be drastically reduced if a handful of countries, such as France and Spain, fully absorb the RRF loans they are entitled to under the RRF regulation.

[1] Composed of: €225 billion of unused loans from the RRF, €20 billion in grants from the sale of EU Emission Trading System allowances currently held in the Market Stability Reserve, up to €26.9 billion from cohesion funds which could be made available in voluntary transfers to the RRF and €7.5 billion through voluntary transfers from the Common Agricultural Policy

- Fourth, supply chain bottlenecks and inflation on primary materials that are crucial for energy efficiency and RES investments mean that energy transition related investments mobilised via the totality of EU funds could deliver lower renovation, electrification and renewable penetration targets than initially envisaged. Hence, the investment gap may increase through this additional channel.

Beyond the dissonance between RepowerEU targets and the financial means to achieve those, the EC's proposal entails additional extremely problematic dimensions, which are analysed below. More concretely, we consider that:

- the proposal to mobilise the Market Stability Reserve of the ETS should be entirely scrapped and replaced by other viable means of income generation, which we outline;
- the proposal to waive Do No Significant Harm (DNSH) requirements for "security of supply" related investments should equally be entirely scrapped, as it will lead to an increase of fossil fuel investments across Member States;
- the reopening of the RRF regulation should be harnessed to improve several pitfalls of the original RRF regulation, notably concerning public participation and monitoring, as well as the regional distribution and social dimensions of RRF funds.

## 2. Comments on using the Market Stability Reserves of the ETS

The Commission proposed to release allowances held in the Market Stability Reserve (MSR) to generate € 20 billion through amendments to the Emissions Trading System (ETS) directive and the Market Stability Reserve (MSR) decision. This proposal is highly problematic for several reasons:

- First, it puts at risk EU climate targets: at current carbon price levels, the release of 220-250 million allowances from the reserve would be required to generate the foreseen € 20 billion. Unless scarcity prevails in the market, these allowances would otherwise have been cancelled or kept from entering the market. The Commission claims that the reserve will re-absorb these released allowances in the period before 2030 and that the measure will therefore not undermine the achievement of the ETS 2030 target. This is highly questionable. Analysis by Sandbag underlines that the measure is likely not neutral on the supply and demand balance of the EU's carbon market and could result in up to 198 million additional allowances in circulation by 2030, thereby risking to miss the EU's climate objective.
- Second, it diminishes overall ETS revenues: EUA prices immediately dropped by 12.5% in response to the Commission's amendment proposal in May. Lower carbon prices not only entail that a higher number of allowances would be needed to generate the € 20 billion, but also results in reduced overall available revenue from the auctioning of ETS allowances, impacting both Member States income and the envelope of ETS funds, such as the Innovation Fund.

- Third, it breaches ETS spending criteria: according to the Commission's plans the revenue generated by the Market Stability Reserve would contribute to a EUR 225 billion portfolio dedicated to finance measures proposed under the REPowerEU plan. Out of these, it is expected that EUR 11.5 billion will be used as investments in fossil gas and oil infrastructure. Beyond the fact that these fossil fuel investments are unnecessary (see section on DNSH below), this is in blatant contradiction to the stricter spending criteria for ETS auctioning revenue, proposed by the European Commission under the current reform, that exclude all investments in fossil fuels.
- Fourth, it would constitute a dangerous legal precedent: the core objective of EU environmental and climate policy is to protect the environment and reduce greenhouse gas emissions, not to generate revenue, and particularly not to fund fossil fuel projects. Politically interfering into the market with the primary objective to generate extra funding would set a dangerous precedent and fundamentally undermine the credibility of the carbon market, likely leading to further downward pressure on the EUA price - and hence reduced decarbonisation incentives and overall revenue - in the mid-and long term.
- Fifth, the ETS is being undermined to mobilise an extremely meagre amount, particularly if factoring in respective allocation keys to individual Member States. Indeed, alternative sources of financing through ambitious policies to raise own resources (see below) could lead to the mobilisation of adequate financing for delivering RepowerEU targets and fill the aforementioned investment gap.

## 3. Comments on alternatives to the use of the MSR

First and foremost, alternative funding sources need to be seriously considered. EU climate policy serves to address the climate and environmental emergency we are in, not to serve as a funding source. This is why EU decision-makers should fully reject the proposal to generate the required revenues via the EU carbon market and the reserve. As outlined above, the harm and risks associated with a measure that alters the supply and demand balance of the EU carbon market by far outweigh those of possible alternatives. Hence, we are calling to reject the amendments of Article 4 and 5 proposed by the Commission.

Decision-makers should not narrow possibilities by looking into ETS revenues only. Indeed, some alternative proposals to reach the €20 billion figure, such as transferring for Modernisation Fund or Innovation Fund resources would simply consist in shifting budget lines towards the RRF without necessarily providing additionality for ambitious RepowerEU targets. As such we urge decision makers to urgently look at broader possibilities to generate sufficient funding needed to fill the climate investment gap.

First, decision-makers should consider "out of the box" options to raise the EU's own resources, for example via a financial transaction tax or a digital tax.

Second, decision-makers should consider the transformation of remaining RRF loans into grants, while creating a fair allocation key for the remaining untapped loans of the RRF. As aforementioned, the stock of funds available via the loan facility could be exhausted if a handful of countries decide to mobilise the loans they are entitled to under the RRF regulation. In turn, this would significantly reduce the pool of available resources for RepowerEU in Member States facing significant national funding constraints (notably over indebted ones).

Even within the ETS there are much better alternative avenues: in particular, to generate the revenue from an equivalent reduction in free allowances without putting at risk the integrity of the carbon market or undermining investor confidence and thus the carbon price signal. Under the Commission proposal to revise the EU ETS, 4.8 billion allowances are still expected to be handed out for free in the period between 2021-2030. Another option would be creating a dedicated pool from auctioned allowances under Article 10(1) of the ETS Directive would ensure a collective contribution to raising the revenue required.

## 4. Comments on RepowerEU chapters and Do No Significant Harm

In principle, we welcome the proposal to add a dedicated chapter on RePowerEU in the Recovery and Resilience Plans (RRPs). However, we are strongly opposed to the waiving of the "Do No Significant Harm" obligation for the part of the RepowerEU chapters dedicated to diversifying fossil fuel sources.

Within the RRF regulation (EU) 2021/241, "Do No Significant Harm" (DNSH) provisions (art. 4a) are the only provisions that limit possibilities for extensively financing fossil fuels through the RRF. The Commission's Technical guidance on the application of 'do no significant harm' under the Recovery and Resilience Facility Regulation clearly stipulates that *"measures related to power and/or heat generation using fossil fuels, as well as related transmission and distribution infrastructure, as a general rule should not be deemed compliant under DNSH for the purposes of the RRF, given the existence of low-carbon alternatives […] Exceptions for measures related to power and/or heat generation using natural gas, as well as related transmission and distribution infrastructure, can be made to this general rule, on a case-by-case basis".* The detailed conditions under which fossil gas related projects can be financed are outlined in Annex III of the Commission's technical guidance.

In the current context, these exceptions are already problematic as they are fuelling the inclusion of fossil gas related investments in several recovery plans. Unless they are amended, such investments could deepen the EU's reliance on imported fossil gas, notably from Russia, reduce energy security while contributing to a lock-in into high-emissions and high-cost fossil fuel sources.

However, article 21c (par. 2.4.) of the European Commission's proposed amendment to the RRF regulation goes a step further by fully waiving the DNSH provisions for *"measures improving energy infrastructure and facilities to meet immediate security of supply needs for oil and gas".* This derogation is accompanied by extremely weak, if not non-existent, safeguards through a general mention of "not hindering the overall progression towards the 2050 climate targets, taking into account the national energy and climate plans".

Article 21c (par. 2.4.) should be fully rejected for the following reasons:

- First, this derogation opens the door to the financing of virtually any fossil fuel project, whether upstream, midstream or downstream - plausibly with no exception. A full derogation with no serious safeguards mean that any investment could potentially be justified on "diversification" grounds, fuelling a path dependence into new fossil fuel infrastructure.
- Second, it would consist of a serious backtracking of eliminating fossil fuel finance from EU funds. Indeed, a large span of fossil fuel related investments (e.g. coal and oil related, as well as upstream gas) have already been excluded both under Next Generation EU and the 2021-27 MFF, and the EU has committed to phase out fossil fuel subsidies (including concessional finance from EU funds) by 2025 at the latest.
- Third, it is unnecessary from an energy security standpoint. Among others, CAN Europe's recent briefing based on the Paris Agreement Compatible Scenario demonstrates that it is possible to wean off Russian gas in only four years, without additional gas imports from elsewhere, with more ambitious action to curb energy demand, ramp up sustainable renewables and roll out flexibility options.
- Fourth, its rationale is misleading. According to the European Commission, a DNSH derogation is necessary for *"guaranteeing the short-term security of supply"* for *"a rapid reduction of dependency on Russian suppliers"*. These assertions miss the crucial point that new oil and gas infrastructure (e.g. LNG terminals, alternative pipelines, oil refineries) would take years to plan and build - hence failing to contribute to short-term security of supply. In short, the idea that it takes less time to develop new fossil fuel infrastructure to replace Russian fossil fuel imports, compared to the roll-out of renewable alternatives, is flawed.
- Last but not least, this derogation creates serious legal inconsistencies: whereas investing in a solar PV plant will need to comply with DNSH provisions (e.g. demonstrating that it does not harm biodiversity and circular economy objectives), this will not be the case for environmentally damaging fossil fuel investments. These legal inconsistencies set a dangerous precedent for the implementation of the DNSH principle in EU funds.

Beyond our call to fully reject article 21c (par. 2.4.), we equally note the following:

- The proposed amendment to the RRF regulation should be complemented by a provision incentivising the fast replacement of existing investment plans in fossil gas (e.g. gas boilers roll-out) with renewable alternatives (e.g. accelerated heat pump roll-out) within respective recovery and resilience plans. This would help prevent a deepening of the EU's reliance on imported fossil gas from Russia and elsewhere.

- As already analysed in a previous Green 10 briefing the DNSH principle, however innovative and important, has been poorly applied in a number of Recovery and Resilience Plans (RRPs). If anything, the lesson from RRPs is that DNSH screening criteria should be tightened in all EU funds.

## 5. Comments on provisions for public consultations and public participation in designing and monitoring RRPs and RepowerEU chapters

The lack of proper involvement of civil society organisations characterised the entire preparation of the national recovery and resilience plans across EU countries. The RRF Regulation (EU) 2021/241 provides general and weak provisions in terms of engaging stakeholders: for the preparation and implementation of the plans, Member States were simply "invited to provide a summary of the conducted consultations with the relevant national stakeholders". Equally, the Commission's Guidance from February 2021 failed to impose strong binding obligations for governments to involve partners in a structured and inclusive manner. Once again, Member States were merely encouraged to involve civil society and this, combined with the rushed process of preparing plans, inevitably affected the content of the plans. This has been raised by the European Parliament, who have on several instances deplored the fact that many "relevant stakeholders were not sufficiently involved, in the design and the implementation of the NRRPs". As a result, stakeholders have had very limited possibilities to propose concrete measures, or even to be aware about the final plan until the submission or final approval by the European Institutions. Conversely, in countries where the preparation took longer (e.g. in Bulgaria), civil society organisations had the opportunity to better contribute to the content of NRRPs, leading to improved and more ambitious measures to address the challenges.

Similarly, regarding the implementation of NRRPs, there are poor requirements in the current regulation to involve stakeholders and inform them about the opportunities arising from the plans. Despite those shortcomings, some governments have put in place monitoring committees in an attempt to address the calls from civil society organisations and other stakeholders to open up the implementation. Nevertheless, recent analyses on the state of play of Monitoring Committees in fifteen EU Member States show that even when such Committees are in place, their structure, compositions and organisation fail to properly involve external stakeholders.

Therefore, based on the previous RRF experience, it is clear that these vague and weak references to stakeholder involvement have largely not been followed by Member States, evidencing the need for stricter and more explicit requirements.

The proposed revision of the RRF regulation, to include REPowerEU chapters in the recovery and resilience plans, should strengthen the role of the civil society with strong and formal obligations applied to the Member States. This is even more crucial as these chapters are dealing with crucial choices which will have to be undertaken to reduce Europe's dependency to Russian fossil fuels, which in some countries is currently huge, and to considerably speed up the uptake of renewables and energy savings.

Those investments require a paradigm shift with the full support of our societies and co-creation should be the key to address these. Unfortunately, we regret that the Guidance on Recovery and Resilience Plans in the context of REPowerEU fails to accomplish such results as it does not come with the necessary changes to begin a proper consultation process. In particular:

- As in the initial RRF Regulation, the REPowerEU Guidance invites governments to provide a summary of consultations - verbatim: “Member States should provide a summary of the consultation process conducted in accordance with their national legal frameworks, leading up to the submission of the modified RRP/addendum”.
- It also states that: “The consultation process should be commensurate with the magnitude of the changes introduced in the RRPs. For instance, modifications to reflect a slightly amended financial allocation would not require the same type of consultation process as requesting a significant loan amount.”. This is worrying as it could undermine the already weak role of civil society in the process in some cases.

This is even more problematic considering that the Commission proposes to shift money from cohesion policy towards the RFF to finance REPowerEU chapters, whereas cohesion policy funds come with strict requirements related to the partnership principle, where national authorities are required to involve stakeholders through the whole programming process, from the preparatory stage to the implementation and assessment of the results. In this regard, the potential consequences of the REPowerEU plan on the RFF would mean downgrading the application of the partnership principle.

We welcome that the Commission recognises the role of stakeholders by stating that “the implementation of the RRPs will only be successful with strong regional and local ownership, as well as support from social partners and civil society.”. Civil society should be engaged not only to achieve a successful implementation of the recovery plans, but because the involvement of partners is central to the EU Green Deal.

We therefore call upon to strengthen the paragraphs on civic participation and consultation in Article 2 and 3 of the proposed Regulation. This could specifically involve, for example, regular and obligatory meetings between national based Commission staff, responsible national authorities and stakeholders including civil society organisations, social partners and local authorities, to assess progress and raise concerns.

## 6. Comments on RepowerEU chapters, social and spatial inequalities

Given the dramatic social impacts of the current energy crisis, it is crucial to ensure that the investments included in RepowerEU plans prioritise measures which can contribute to a socially just transformation by targeting the most vulnerable households. For example, the design of energy efficiency measures in respective Member States, as well as measures to roll-out heat pumps and renewables (e.g. rooftop solar, energy communities) are not always adequately prioritising energy poor and vulnerable households.

Although we welcome that article 1 (1) of the proposed amendment explicitly mentions that the objective of the facility (and RepowerEU plans) includes “mitigating the social and economic impact of that crisis” and an “upward economic and social convergence”, this is provision is insufficient and is poorly reflected in the assessment guidelines of the plans (Annex 1 of the proposed regulation). Indeed, the latter fails to include distributional outcomes as a key assessment criterion.

What holds for social inequalities equally holds for spatial inequalities. Indeed, the transfer of resources from the ERDF to the RRF for financing RepowerEU-related measures could translate into a reduced pool of funding for regions, including poor regions of the Union. Yet, the proposed amendments fail to strengthen regional provisions in the RRF regulation (Annex 5 of the RRF regulation & Annex 1 of the proposed amendment), in order to ensure that RepowerEU chapters adequately take into account spatial inequalities in the targeting of energy efficiency and renewable investments.

As such we consider that:

- Article 1 (1) of the proposed amendment should be strengthened vis-à-vis distributional outcomes, considering both social and spatial inequalities in the design of RepowerEU related measures
- Annex 1 of the proposed amendment should be complemented with assessment criteria that include addressing both social and spatial inequalities, which are exacerbated by the current energy crisis, in respective RepowerEU investment programmes and reforms.

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