Alternative Ways to Finance the Social Climate Fund

Report from FEANTSA online event – March 2022

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In the context of the ecological transition and to meet the commitments of the European Green Deal, the European Commission has recently launched the proposition of extending the EU Emissions Trading System (ETS) to transports and buildings to reduce carbon emissions ("ETS2"). The Social Climate Fund (SCF) that is being considered to offset the social costs of this measure is not adequate to deal with the extension of the ETS. This extension is expected to have a disproportionate negative effect on the European middle and lower classes. With 30 to 50 million Europeans currently experiencing energy poverty, and with gas prices skyrocketing, the creation of a stronger SCF is necessary to tackle energy poverty. In this online event organized by FEANTSA, experts debated on the alternative sources of funding available to finance a better SCF.

The first panel focused on the lessons learned from Czech Republic & Germany in using revenues from the existing ETS to finance housing renovations with a rising focus on low-income households.

Petr Uhlíř, architect and external consultant for the Czech Ministry of the Environment, presented the New Green Savings Program (NGS). The NGS is a Czech nationwide energy efficiency program from 2009. The NGS program provides subsidies for the renovations of residential buildings to improve their energy performance, the construction of new energy-efficient buildings and the promotion of an efficient use of new and renewable energy sources. It includes support for DIY ("Do It Yourself") measures, which is seen as an important way to enable communities to support themselves and to reduce the costs of renovation. The program has gone through several phases and has been gradually upgraded.

The NGS program cannot be considered an example of good practice in using revenue from ETS allowances to finance energy renovations with special assistance for poorer households. In a structural point of view, it is based on ex-post financing, which is a crucial barrier for the use of this program by low-income households unable to provide up-front costs. Moreover, the second stage of the program (2014 - 2021) did not contain any 32 benefits for low-income households. The current phase of the program (2021 - 2025) is no longer financed by ETS allowances (it is now part of the Recovery and Resilience Facility, which was considered a better source of financing). While the program already includes some benefits for energy refurbishment for low-income households, it is not yet sufficient to motivate these households to become more involved in the program.

The Czech government is currently looking for ways to make the NGS program more accessible to low-income households. Among these new measures that are being prepared to tackle energy poverty, there is a bonus of up to €3 030 for a low-income household that applies for a subsidy for the energy renovation of family house, financial support in the amount of up to 80-90% of eligible costs for energy renovation of apartment houses with social flats (where there is a guarantee that these flats will have the status of a social flat for at least 10 years after the renovation work), and a loan for a low-income household that has applied for a subsidy from the NGS program for pre-financing energy renovation. Finally, the possibility of reusing ETS revenues for renovations is under discussion. For Mr Uhlíř, "there are many opportunities to use the ETS revenues".

Anna Wolff, Policy Advisor on Energy and Climate at Deutsche Umwelthilfe e.V., presented the Federal Funding scheme for Efficient Buildings (Bundesförderung für effiziente Gebäude - BEG). The Climate and Transformation Fund (Energie-und Klimafonds - KTF) was introduced in Germany in 2011. It is partially funded by ETS revenues, national CO2 pricing and the federal budget. The Fund provides financing for environmental transition programs, among which the Federal Funding scheme for Efficient Buildings (Bundesförderung für effiziente Gebäude - BEG). This programme was launched in January 2021 and implemented as the KfW's (Kreditanstalt für Wiederaufbau, a German development bank) "Energy-Efficient Construction and Refurbishment programme". It is composed of three sub-programmes: one for residential buildings, one for non-residential buildings, and one for individual measures (smaller renovation projects). In 2017, the renovation programme allocated financial support to modernise 275 000 dwellings. Currently the BEG does not take into account the different economic capacities of households, and therefore does not include any measure focusing on the lowest income groups.

According to a report from the Deutsche Umwelthilfe e.V. presented by Anna Wolff, **there is too little funding in the BEG for the refurbishment of the building stock.** While 95% of the building stock was built before 2012, much of it is still in need of renovation and thus not in line with the EU climate neutrality target. But instead of focusing the funding on renovating the existing building stock, the BEG funding was primarily used for new constructions. Indeed, although the BEG funding was multiplied by 3 between 2020 and 2021, the report highlights a 15-fold increase in subsidies for new constructions between 2019 and 2021, and only a 6-fold increase for complete renovations. "How inefficient this distribution is, is becoming even clearer when it is considered that new construction has accounted for less than 5 % of the building stock since 2012, but nearly 60 % of subsidies have gone to new construction".

For Anna Wolff, solutions exist to improve the allocation of the KTF fundings for socially-just renovations in Germany. Among these solutions, there is the permanent increase of the funding to € 25 billion per year and focusing the funding on the existing building stock's renovation with climate compatible standards, so as to mitigate rent increases and support residents of low-efficiency buildings who are particularly exposed to high energy prices. Another solution she proposes is a bonus for private low-income owners in parallel with the introduction of the Minimum Energy Performance Standards.

The <u>second panel</u> focused on using the European Central Bank's (ECB) Targeted Longer-Term Refinancing Operations (TLTROs) programme, to make green lending much more affordable for small businesses and households.

Stanislas Jourdan, Executive director at Positive Money Europe, presented how to target a sustainable recovery with Green TLTROs.

Stanislas Jourdan recalled that the renovation of buildings is a crucial priority, given that the EU has 34 million citizens in energy poverty and could save 50 billion euros in energy costs if it succeeds in meeting its energy efficiency targets. Reducing the EU's reliance on imported fossil fuels will contribute to reducing the impact of energy prices in the inflation index. 220 million buildings need to be renovated by 2050, which means that 150 to 275 billion additional investments are needed per year.

Banks can play a key role in unlocking deeper renovation. The current use of public money for energy is not optimal and effective to achieve environmental targets. The speaker argues that there are limitations in the current public subsidies. Most households finance renovation from their own savings. Most renovation are light and partial renovation (in France only 2 500 dwellings achieve high energy efficiency performance among 644 000 grants), grants are unscalable, households face the complexity of the process, delays and upfront costs, and the subsidized loans are often capped. Hence, it is necessary to make the banking sector play its part in the process to unlock the trillions for the renovations.

Currently, there are barriers to bank financing. For clients, these barriers can include reluctance to borrow more money, lack of availability of savings and disposable income, high cost of credit and not qualifying due to lack of collateral and too short a term, cost of energy assessment and other upfront costs, complexity of accessing public assistance programs, lack of technical assistance, and discomfort during renovation. On the bank side, barriers include low profitability of small retrofit loans due to high fixed costs, lack of collateral on retrofit loans, lack of expertise in energy retrofit, certification, and auditing.

A combination of innovative financial instruments and a green discount rate by the ECB's refinancing operations can make cheap loans available for millions of households. Positive Money proposes concrete measures to involve the ECB in unlocking financing for the renovation wave.

The first measure is the creation of an **EU green renovation loan standard**: a new bank lending product to incentivize banks and consumer to carry out deep retrofitting. The issuance of this loan would be conditioned to the purpose of carrying out deep renovation (in compliance with EU standards), with zero interest (or capped by EU's cost of borrowing eg. 1%), with a maturity of 30 years, and with not mandatory monthly repayments (the repayment is made in full when the house is sold or transferred, or after 30 years.)

The second measure is the implementation of **mortgage portfolio standards** to oblige banks to report the energy efficiency performance of their mortgage portfolios, and to achieve ambitious targets (Art. 15 of EPBD recast).

Third, there is a green discount interest rate by the ECB to compress financing costs for banks and consumers (**green TLTROs**). The TLTROs correspond to loans from the ECB to banks at negative rates (-0.5%). This is a lending incentive, as banks receive an even more negative interest rate (-1%) if they reach a certain lending volume. For now, there are no environmental conditions. Positive Money proposes the creation of green TLTROs: the launch of a pilot project including a reduced interest rate on the % of renovation loans issued by banks.

Finally, Positive Money calls for a **smarter use of public funding** for upskilling programmes, technical assistance and one stop shops, and grants for most the vulnerable groups.

During the Q&A, Stanislas Jourdan acknowledged that one of the risks of the measure is that the money will be distributed unevenly across Europe and that banks will run to the most profitable incomes. He argued that public intervention and grants will still be needed to allow for renovations for all but emphasized that the renovations loan proposed by Positive Money makes everyone eligible as it is risk free for banks.

The third panel focused on the implementation of a fairer taxation system to finance the SCF.

Félix Mailleux, advisor on climate, energy, and industrial policies at the European Trade Union Confederation (ETUC) presented ETUC position on the financing of the Social Climate Fund.

New funds could be made available to finance the SCF through a fairer tax system, with the introduction of new taxes on capital. For Felix Mailleux, the existing tax system is shifting from labour taxation to environmental taxation, the latter being supposed to finance both the ecological transition and part of the public budget. He criticizes the incoherence of environmental taxation, and the fact that it is more regressive because it is a VAT tax where everyone is affected in the same way, while labour taxation is more progressive because it is based on income. While environmental policies work well, environmental tax revenues are also limited in time.

This is the reason why ETUC proposes a shift from labour taxation to capital taxation to reach a fair taxation system. However, the goal is not to rely solely on this source of revenue to finance the transition, nor to invest all the revenues from these new taxes in the transition.

ETUC does not reject the idea of creating a carbon pricing mechanism, but states that "this should not be the only tool for climate action". However, for road transport and buildings, the extension of the ETS to building and road transports does not seem to be the appropriate tool, because of its regressive distributional effect, territorial differences in Europe, and the inelasticity of the transport and building market which will mean that rich citizens will be able to make investments in the short term and only poor households will finance the measure in the long term. However, ETUC welcomes the creation of the SCF.

To find more sustainable sources of financing for the SCF, ETUC proposes the introduction of a Financial Transaction Tax, a Common Consolidated Corporate Tax Base, a Digital tax, or a Wealth Tax. The revenue potential of the financial transaction tax depends on its design but can be estimated at between 0.3% and 1.4% of EU GDP. The revenue potential of a Common Consolidated Corporate Tax Base can be estimated at between 1.3% and 3.8% of EU GDP, a Digital tax could be linked to it. The introduction of a European Wealth Tax could be a way to tackle inequality (99% of EU households would be exempted from this tax) and would represent 1.6% to 10.8% of EU GDP. To finance the SCF, ETUC supports the use of other revenues, such as revenues from the existing ETS.

On the question of the likelihood and timetable of implementation of these taxes, Felix Mailleux replied that it depends on the political will, and that if the unanimity needed in the EU Council makes the process difficult, it is necessary to start thinking about other ways than carbon pricing to finance the transition: "The green transition is an unprecedented challenge, and we must remove the taboos. The current geopolitical context shows that with political will, we can go far." Moreover, he reminded that the financial tax has been considered among the possibilities set by the Commission to pay off Covid's debt, but without any concrete proposal for the moment.