EURIMA Response to the European Commission's proposal to extend the EU ETS to heating fuels for buildings

The Fit-For-55 Package leaves no stone unturned when it comes to emissions trading and exploring how carbon pricing can contribute to the EU's 2030 climate target plan. Whilst the ETS has proven highly effective in reducing emissions in certain sectors, it is clear that cap-and-trade, and carbon pricing more generally, does not deliver an increase in renovation activity. This paper explains why that is the case, what other policy tools in the Fit-For-55 Package should be used to boost the rate of renovation, and how an extended ETS should be designed in order to strengthen and not compromise those policy tools.

Carbon pricing cannot address the key barriers to renovation

Decarbonising the building sector requires a multifaceted approach that addresses each barrier to renovation with the most appropriate policy instrument. But not all barriers to renovation are equal in importance, and therefore, neither are the policy solutions.

The most significant barriers to renovation are non-economic in nature. According to the International Energy Agency[1], most of the energy efficiency potential is available at a negative cost, meaning that most energy efficiency measures pay for themselves and are therefore held back by non-economic factors. These factors are market-barriers and -imperfections, including split incentives between those making investments (i.e. home-owners) and those paying energy bills (i.e. tenants), the inability to come up with high upfront costs and a lack of information on renovation opportunities and financing options.

For this reason, any policy tool that merely activates a price signal can only ever have a marginal impact. Therefore, whilst extending the EU ETS can potentially reduce payback periods of certain energy efficient technologies and long-term energy service contracts, it is clear that the measure cannot deliver the kind of boost to the EU renovation rate that is needed in the next decade.

The most comparable existing scheme was launched in Germany in 2019. Although it is too early to draw any conclusions on its effect on the German renovation market, its starting phase was challenged by a number of unresolved issues, such as the question of allocating the burden to landlords or tenants. Carbon taxation, on the other hand, has been used to target heating fuels in a number of EU countries, in some cases for several decades. However, even in these Member States, there is no evidence that such measures have triggered large-scale deep renovation.

[1] IEA (2011), Summing Up the Parts – Combining Policy Instruments for Least-Cost Climate Mitigation Strategies (see here)

Aligning the measure with other proposals in the FF55 Package

Given that the proposal to extend the ETS to buildings will not materialise in significantly higher rates of renovation, the Commission is right to propose a revised, more ambitious Effort Sharing Regulation (ESR) in line with the upgraded 2030 greenhouse gas reduction target. One of the key sectors under the ESR, namely buildings, emits 36% of GHG emissions and consumes 40% of energy in Europe.

It is also encouraging that the Commission has aligned this level of ambition with its proposal to revise the Energy Efficiency Directive, which includes provisions ensuring that public buildings lead the Renovation Wave, coupled with a substantial increase in the Energy Savings Obligation.

But the element of the Fit-For-55 package with the greatest potential for tackling barriers to renovation – the revision of the Energy Performance of Buildings Directive (EPBD) – will only be published later this year. This is an opportunity to introduce minimum energy performance standards (MEPS) for existing buildings and a strong supporting framework to enable MEPS compliance via financial, technical and administrative assistance for building owners, national/regional authorities and relevant professionals. Together with the EED, these measures can ensure that the Fit-For-55 Package is aligned with the objectives of the Renovation Wave.

Whilst the Commission stresses the complementarity between the ETS extension and more ambitious ESR measures, Eurima foresees potential difficulties in implementing more ambitious ESR policies in parallel to the ETS extension. This is because both ambitious ESR policies and the ETS extension result in higher energy costs being passed down to consumers. For one, many EU Member States have at least partially achieved their EED ESO by introducing energy efficiency obligation schemes (EEOS) for fuel suppliers. Whilst these policies have delivered tangible results and should therefore be encouraged, they have also raised alarm bells in some Member States over increases in energy bills stemming from EEOS for those households that are yet to renovate their homes. The proposal for a revised Renewable Energy Directive (RED), which includes a minimum share of renewables in buildings, will generate additional costs to fuel suppliers, which in turn will be passed down to consumers.

These examples show that while the positive effects of an ambitious EED, RED and ETS extension are wide-ranging, they all share one major negative social impact – higher energy bills. This should not deter the Commission from proposing ambitious ESR policies. On the contrary, a strong EPBD proposal with MEPS at its core can mitigate some of the impact of higher energy bills. But it does have two major implications on the Fit-For-55 Package: (1) the timeline of measures has to be carefully considered, ensuring that households are provided with sufficient opportunity to renovate their homes in advance of any significant rises in energy costs, (2) the energy efficiency first (EE1st) principle should be further deployed in a context where implementing a number of policies that each incrementally raises energy costs all at once could lead to a cumulative effect on energy prices that is unacceptable to EU citizens and their national representatives.

With this in mind, it is important that the Commission prioritises EE1st and policies like the EED and RED that have already delivered tangible results – far outweighing their negative externalities – over the ETS extension to buildings which is unlikely to deliver significant savings, making for a much less favourable risk-to-reward ratio. Concretely, the Commission can achieve this by prioritising measures that deliver on deep renovation, such as EED Article 8, which must be designed to incentivise measures focused on the most vulnerable households.

Timing and funding

Already now, as affirmed in the latest IEA Net Zero Report, the front-loading of measures to boost renovation is required in order to enable progress on other EU energy and climate goals such as electrification and the transition to renewables in heating and cooling. Should the extension of the EU ETS take place, the need to front-load renovation-related measures in the EPBD and EED will become even more apparent and urgent, as the social acceptability of the ETS extension can only be ensured by raising the bar on renovation and phasing out worst performing buildings through new regulatory tools like MEPS and a reinforced supporting framework enabling MEPS compliance.

This will require additional funds dedicated to subsidies for deep renovation and funds dedicated to supporting Member States with technical and administrative assistance. Some countries, like France and Czechia, already use ETS revenues to support building renovation. The new ETS for buildings should complement, not seek to replace such arrangements. According to the Commission's estimates outlined in the Renovation Wave strategy, EUR 275 billion of additional annual investments are needed to achieve the 55% climate target by 2030.

Therefore, the new cap-and-trade mechanism should come with strict conditionality outlining how revenues generated by the policy should be spent to contribute towards closing this investment gap in building renovation. Eurima welcomes the Commission's proposal to introduce such conditionality, but regrets that this only refers to "part of the revenues" as opposed to all revenues. Given the scale of the investment gap, all revenues generated by the new ETS (except for the allocation to road transport) should be ring-fenced to subsidise deep renovation. Additionally, a monitoring mechanism should be designed to ensure that such conditionality supports deep renovation over the long run, and that Member State spending sufficiently contributes to national objectives on energy poverty, which should in turn be outlined in EU countries' Long Term Renovation Strategies.

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