ETS for Buildings (ETS2)

Position Paper, Final 19th of January 2022

Summary

The European Commission made a proposal in July 2021 to establish a new ETS for buildings to stand beside the existing ETS for energy-intensive industries. The proposal envisages a carbon price being put on fossil fuels that are used for heating in buildings in the EU that will be paid by energy suppliers.

The expectation of some in the EU institutions is that this new ETS, known as ETS2, will achieve three outcomes:

a) It will incentivise building owners to take a decision to renovate their buildings, although the impact assessment[1] for the EPBD Recast indicates that such a stimulus to renovate will not occur
b) It will raise funding to finance climate action in the member states of the EU
c) It will act as a complement to the regulatory requirements contained in the recast EPBD

EuroACE – Energy Efficient Buildings, has examined the proposal and finds:

1) The proposed ETS2 will only be one small element in a broader policy and legal framework and will only have a marginal effect on encouraging energy renovations in the EU
2) Member States must maintain and increase their efforts to ambitiously implement the broader energy efficiency policy and legal framework on energy renovation and not be distracted by expectations that the ETS2 will be highly effective
3) There is a high risk of negative distributional effects that will burden those in energy poverty and in low-income groups
4) The elasticity of pricing fossil fuels is very low with several studies indicating that a price in the region of €300 per tonne is needed to motivate additional actions
5) The ETS2 has the merit that it will raise funds (to be lodged in the Social Climate Fund (SCF)) that can be used for energy renovation and to alleviate the burden on the most vulnerable. However, the proposal for the disbursement of monies from the SCF will not address energy renovation at the scale needed
6) Setting up and implementing the proposed ETS2 will take several years, thus delaying any positive effects it may bring. This factor means that any positive effects will come too late for the buildings sector

EuroACE invites reactions to its analysis and is ready to meet with stakeholders to examine the proposal for the ETS2 in more depth.

Background

The European Green Deal and its Renovation Wave Strategy emphasise the role that the energy renovation of buildings can play in helping the EU to achieve its medium- and long-term energy and climate targets. The Renovation Wave Strategy also recognises that not enough is being done to energy renovate our building stock and that a more ambitious and robust legislative framework is needed to encourage action on buildings.

As part of the framework, the Commission has proposed, in its "Fit-for-55" package, to establish a new ETS for buildings (ETS2) to create an economic stimulus for energy renovation to sit alongside the regulatory stimulus of the recast Energy Performance of Buildings Directive (EPBD). The proposal foresees a (carbon) price being put on fossil fuels used for heating in buildings. The obligated parties will be energy suppliers of fossil fuels for heating in buildings, but they will surely pass the additional costs they face on to their individual customers via energy bills.

It is expected by some in the EU that as one part of a wider legislative framework, the ETS2 will somehow help to stimulate action among building owners to undertake energy renovations to reduce their energy consumption and

[1] See Section 6.2 of the Impact Assessment Part 1, page 65 here

Rond Point Schuman, 6 - 8th floor
B-1040, Brussels, Belgium
www.euroace.org

+32 2 639 10 10
@ info@euroace.org
@_EuroACE

Company number: 0898.506.941
EU Transparency Register number: 99005441548-23

reduce CO_2 emissions from buildings in the short- and medium-term. A similar scheme is already up and running in Germany and some early lessons from that national scheme can be drawn on to assess the appropriateness of the proposed ETS2 for the EU level.

EuroACE Analysis

It is the position of EuroACE that carbon pricing alone cannot overcome the barriers that hinder the uptake of energy efficiency measures. Those barriers are mostly non-economic barriers, leading EuroACE to have concerns that too many expectations for effective impact may be placed on the proposed ETS2, which is considered to be an economic measure. This factor has led to the proposal for the recast of the EPBD, launched in December 2021, to be less ambitious than it could have been in several of its provisions.

Our concerns are detailed in the points below, together with comments on how the proposed ETS2 and its accompanying Social Climate Fund (SCF) could be made more effective in the context of the overall "Fit-for-55" Package.

1. EuroACE firmly holds the view that a strong regulatory framework, well anchored in the Energy Efficiency First Principle, is the best solution to address the main barriers to increasing the rate and depth of energy renovation in the EU. Any such framework must be coherent across relevant policy areas and all along the supply chain and must include enabling conditions such as the availability of independent advice, technical and project development assistance. The ETS2 will only be a small cog in this extensive regulatory framework and although it should provide additional funding, it will do little to incentivise energy renovation per se (see point 3 below).
2. Creating the ETS2 entails the risk of diverting the attention of legislators (at both EU and national levels) away from designing and implementing a strong regulatory framework for the energy renovation of our buildings and towards fuel-switching policies. It is indispensable that the introduction of the ETS2 does not detract from the ambitious recast of the EPBD but should, if adopted, contribute to the strengthening of the ambition and measures dedicated to building renovation in the EPBD. The key element of the recast EPBD that is of most concern to EuroACE is the setting of clear regulatory milestones for existing buildings through the proposed introduction of minimum energy performance standards (MEPS) facilitated with subsidies and fiscal incentives (see point 10).
3. EuroACE acknowledges that putting a carbon price on heating fuels, will send a price signal, but will not automatically make energy renovation financially more attractive nor technically easier, and will have an adverse impact on the most vulnerable consumers who will face higher energy bills. In fact, there are several studies that have examined the elasticity of putting a carbon price on fossil heating fuels to motivate building owners to energy renovate. The results show an extremely low elasticity with a price in the region of €300 per tonne needed to have a measurable effect on renovation actions.
4. Additionally, the specific design of such a scheme is complex and takes time. Its design should be carefully assessed to ensure that it drives effective action and minimises adverse effects especially on vulnerable consumers, who suffer from the combination of multiple challenges including poor housing that generates high energy bills. We recall that the only long-lasting solution to energy poverty, in its various forms, is deep energy renovation of the affected buildings that drives down energy needs to a very significant level.
5. Considering the current housing crisis, a point of specific attention should be to anticipate the question of "who will pay" for the additional costs that the ETS2 will bring with it. Several countries in the EU have a higher share of tenants as compared to owner-occupiers. Thus, the implementation of the ETS2 will face additional socio-economic challenges as many of the countries allow landlords to pass on renovation costs to tenants, driving them further into financial difficulties. This is borne out by the German experience to date with its recently introduced ETS scheme for buildings. Thorny issues around who should pay the additional costs have emerged, as it is mainly tenants that are bearing the financial burden. This means that the incentive effect on landlords is negligible. Addressing this issue in the design of the ETS2 will be

fundamental as otherwise the ETS2 scheme will lead to landlords not being incentivised, leading to very little renovation action on the ground.

6. It will take several years to put the ETS2 into place and several more to ensure its effectiveness. These factors will significantly delay any positive incentivising impact that its introduction will have. The time it will take to create the ETS2 scheme should not be used by the EU or its member states to defer or delay the introduction and adoption of other more fundamental and effective regulatory, financing and support actions.
7. A just transition depends more on the implementation of effective policies than on high energy prices that deter energy consumption practices. EuroACE points out that energy price rebalancing to better reflect the carbon impact of different energy sources and technologies could be better achieved through the revision of the Energy Taxation Directive.
8. Another fundamental issue is around how the monies raised by the scheme are being used because they could mainly, under the current draft, be used to subsidise higher energy bills and not to encourage ambitious energy renovation works. It would be counterproductive to end up with a scheme that indirectly further subsidies fossil fuel consumption, as around 70% of heating in buildings today is supplied by fossil fuels.
9. As previously stated, EuroACE holds the view that, for a well-functioning ETS2, an equally well-functioning and interlinked regulatory framework should be put in place. In this sense, the interplay between the ETS2 and the Energy Performance of Buildings Directive (EPBD) and the Energy Efficiency Directive (EED) should be secured:
    a. **On the side of the EPBD**: the ambitious roll-out of the proposed minimum energy performance standards (MEPS) for all existing buildings is of crucial importance if the EU is to achieve the climate and energy goals that are already set by the EU for 2030 and 2050. In fact, the member states will have to be more ambitious than the proposal as the Commission's Impact Assessment states that the chosen option will not achieve the 2030 and 2050 targets for the buildings sector[2]. To ensure the successful roll-out of MEPS in the member states, the EU must adopt, based on the published proposal in the "Fit-for-55" package, a solid enabling framework encompassing financial and technical support. The ETS2 revenues could be supportive in this regard, hence their inclusion in robust national long-term renovation strategies (to be called national building renovation plans in the future), along with the establishment of technical assistance facilities (i.e., One-Stop-Shops), could be of importance.
    b. **On the side of the EED**: As Article 8 of the EED RECAST requires Member States to achieve a share of their cumulative energy end-use savings among people affected by energy poverty, the strengthening of the requirement on obligated parties (notably energy suppliers) to achieve energy cost reduction targets and energy savings is crucial. This can be achieved by promoting energy efficiency improvement measures and by providing supporting financing measures that will mitigate carbon price effects. ETS2 revenues generated by the same carbon taxes paid by the energy suppliers could then be directly channelled to support the uptake of these measures.
10. On financing, we note the proposal of the Commission to establish the Social Climate Fund (SCF) to alleviate some of the anticipated negative distributional effects of the ETS2, which will put an additional financial burden on low-income and vulnerable consumers. It is the view of EuroACE that the proportion of monies raised for the SCF from the ETS2 on buildings should:
    a. be used exclusively to finance the ambitious energy renovation of the buildings owned and/or occupied by those that will be most affected by the ETS2 and that
    b. a robust methodology to identify those consumers be established as part of the SCF. For those in energy poverty, the methodology put forward by Article 8§3 EED RECAST could be used, notably the percentage of people affected by energy poverty indicated by Member States' National Energy and Climate Plans (NECPs), or in the absence of such NECPs, the arithmetic average of specific indicators.

[2] See the Impact Assessment Part 1 page 120 here

11. Energy renovations that are funded through the SCF should be planned to achieve at least 60% energy savings after works are completed. Requiring a very low amount of energy in a building is the best guarantee against energy price shocks and the best way to keep bills down. Boosting the energy performance of those buildings through quality deep or staged-deep renovations will also improve the health and comfort of occupants, thus bringing even greater overall benefits for society and for our economies.
12. On an associated financing point, we hold that all ETS revenues (from the existing ETS) should be spent on projects which deliver the most emissions reductions and societal benefits, i.e., energy savings projects notably in buildings. Research undertaken by RAP (see here and here) reveals that dedicating carbon revenues to energy efficiency can deliver 7 to 9 times more emissions reductions than relying on the carbon price alone, and can lower consumer energy bills. Good examples exist in Czechia and in France.

Conclusion

It is only if the ETS2 is embedded in a robust, ambitious energy efficiency legislative framework that the proposal may help achieve the Fit-for-55 ambition. This regulatory framework including MEPS should be fully implemented and supported by a full set of enabling conditions such as technical assistance, project development support and strong financing instruments. The monies raised through the ETS2 for buildings and lodged in the SCF should be clearly directed to exclusively support building energy renovation and the methodology to identify vulnerable consumers should be worked out as a priority.

End of note

Rond Point Schuman, 6 - 8th floor
B-1040, Brussels, Belgium
www.euroace.org

+32 2 639 10 10
@ info@euroace.org
@_EuroACE

Company number: 0898.506.941
EU Transparency Register number: 99005441548-23

For further information

Adrian JOYCE, Secretary General
+32 (0) 2 639 10 10
adrian.joyce@euroace.org
www.euroace.org

About EuroACE - Energy Efficient Buildings

EuroACE represents Europe's leading companies involved with the manufacture, distribution and installation of energy saving goods and services for buildings. EuroACE members employ more than 220,000 people in these activities in Europe and have over 1,100 production facilities and office locations. The mission of EuroACE is to work together with the EU institutions to help Europe move towards a more efficient use of energy in buildings, thereby contributing to Europe's commitments on climate change, energy security and economic growth.

(2021) EuroACE Members