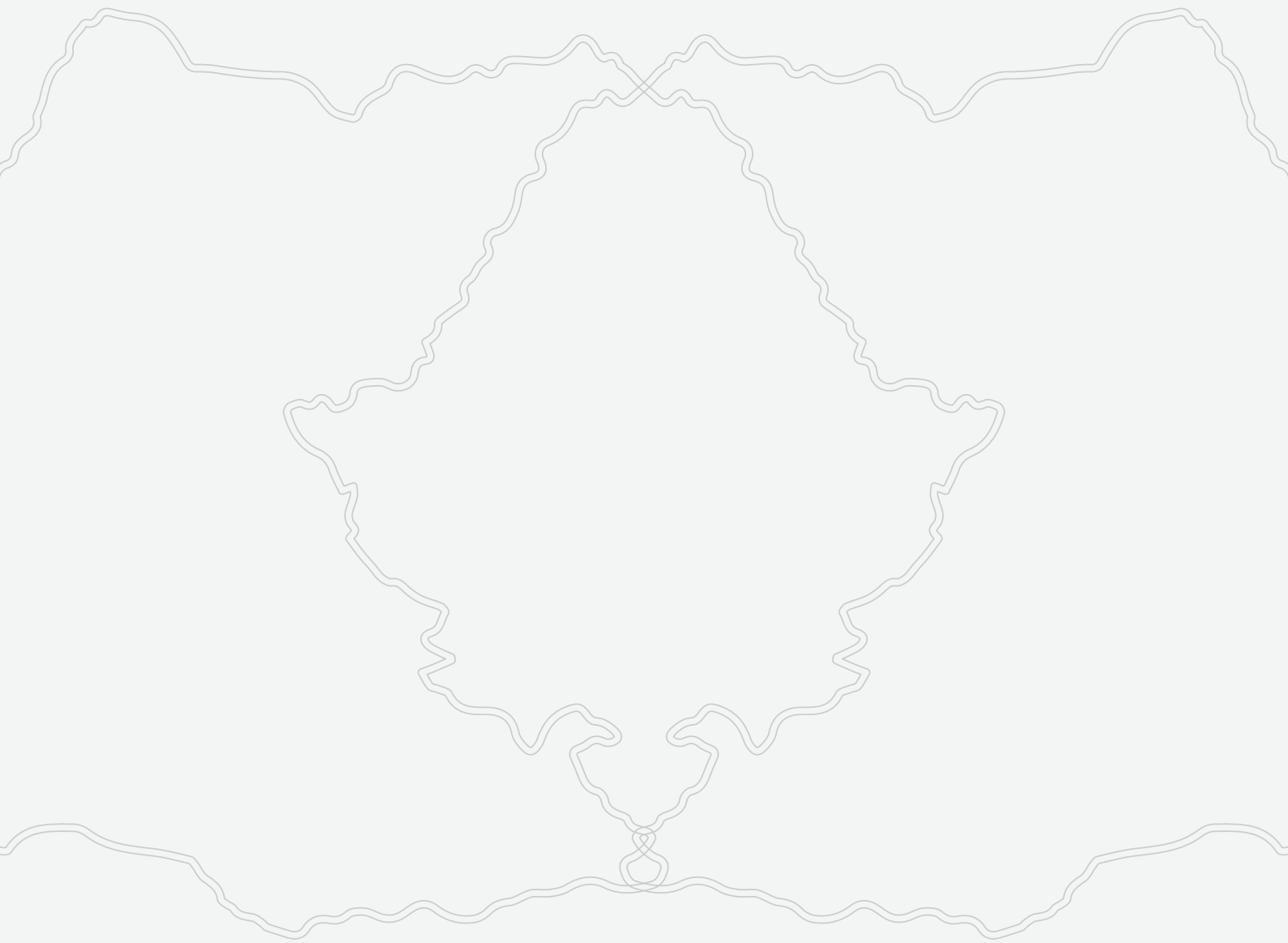


# FINANCING THE LOW CARBON TRANSITION UP TO 2030 IN ROMANIA

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## Introduction

The European Union has agreed to become the world's international largest block to pursue a net-zero economy by 2050, implementing therefore a key commitment of the Paris Agreement, more specifically the need to reach carbon neutrality by the second half of the century. Such a transition towards carbon neutrality over the course of only 3 decades has its highest chances of success in the European Union and in fact, should this transformation fail to happen here, it is very unlikely that the ambitious goals of the Paris Agreement will be met at all, since similar enabling conditions as in the EU will not be found elsewhere.

The EU has a very complex mix of policies which will each play a role in supporting this transition, most of which contains their own set of financial incentives, programmes, or streams of revenue creation. This policy portfolio contains legislation and financial schemes to support:

1. The promotion of research and roll out of **innovation**;
2. Minimal **targets** to support the deployment of low carbon technologies;
3. The oldest, largest and most experienced **carbon market** in the world, whereby its carbon unit certificates are well performing commodities;
4. A wider variety of **sectoral specific programmes**;
5. Most importantly, by pooling together financial resources from its 27/8 Member States, the EU has access to **a common budget in the trillions** for the period 2021-2027 steered towards enhancing cohesion across the internal market space.

One of the biggest challenges in the process of reaching the goal of carbon neutrality for the entire European Union will certainly be the economic and technological diversity amongst the EU Member States. This is in addition to massive differences in the carbon intensity of the mix and the particular nature of Member state's profile in terms of emissions. There will be other challenges, such as getting the right technologies in place at an affordable place, finding alternatives to current industrial processes and fundamentally changing some of the core enablers of our everyday lifestyles (transport, agriculture, buildings, etc.) but nonetheless, the net-zero goal of 2050 will lead the way to unveiling the necessary solutions, if the right economic incentives and support schemes are in place.

The goal will have to be ensuring changes unfold as rapidly across the different economic landscapes comprising the European Union, while the impact on citizens is minimized. Policy decisions affecting the next decades will have to keep a clear focus on harnessing the positive aspects of this long-term planning

goal while maximising the short and medium term opportunities. In this paper we will focus on scoping out the synergic effects of two policies aiming to achieve multiple goals, more specifically policies aiming to both reduce emissions and meet climate objectives and to alleviate the economic discrepancies between Member States. These two are: Cohesion Policy and the EU Emissions Trading Scheme. While the order of priority is reversed in the case of two policies under discussion, with cohesion policy being first aimed at reducing inequality while meeting the climate objectives of the Union and the EU ETS primarily focused on reducing emissions, with several 'cohesion minded' plug-ins to the system, the combination of the two make it a powerful investment boost for the next decade.

## I. The Multiannual Financial Framework 2021-2027

The EU is able to pursue common objectives across different policy areas through its own Multiannual Financial Framework (MFF) which spans over 7 years, more than a political mandate of the European Commission and Parliament, giving investors certainty beyond electoral cycles. This duration is meant to cover a whole economic cycle, which 7 years is often taken as the minimum threshold for <sup>1</sup>. The first proposal on the future such budget covering the period from 2021-2027 was unveiled in May 2018. It plans that at least 25% of the overall expenditures over this period will be mainstreamed for climate action. This objective represents an increase from the current budget (2014-2020) which allocated only 20% of its total to climate action. This paper argues this earmarking is best maximised to 40% of the total amount for a maximum impact on climate investments and cohesion strengthening.

The new MFF also proposes some interesting changes on cohesion policy that would impact its potential on climate action. The Commission indeed proposed the exclusion of "investment related to production, processing, distribution, storage or combustion of fossil fuels" from the scope of support of the European regional development fund (ERDF) and the cohesion fund (2 funds accounting for around € 250 Bn) in a clear acknowledgement of the added value of cohesion policy to climate action. In addition to the exclusion of harmful investments, the European Commission proposed a higher mandatory spending on its policy objective related to climate change mitigation, with less-developed and transition regions having to spend at least 30% of their ERDF allocation on "policy objective

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1. Cusack PTE (2017) More on the 7 Year Economic Cycle and the Bell Normal Curves. J Glob Econ 5: 231. doi: 10.4172/2375-4389.1000231

2: a greener, carbon free Europe". It is important to note that so far, this mandatory spending on climate objective, also known as "thematic concentration" has been extended also to the more-developed regions, even though this specific earmarking, its level of concentration, and the exclusion of fossil fuels could still be modified during the upcoming MFF negotiations.

Furthermore, the European Investment Bank, the world's largest development bank follows the political mandate of the EU and has recently committed itself to being "the climate bank of the EU". Overall, the EU has a financial governance architecture which can finance the transition and in fact can operate as an engine for reinvestment, as it also contains many revenue creation programmes which can then be used to further support the transition.

If the EU is the policy test bed for whether the world stands any chance to meet the ambitious goals of the PA, its handling of the differentiated GDP landscape will be its own test for whether or not it can make it. In this paper we explore the financial mechanisms through which the EU hopes to meet its ambitious climate targets, while setting an example for the global landscape, by zooming in on one specific Member State, more specifically, on Romania.

#### CASE STUDY

### Romania

Romania could almost be said to be set for success in the EU's race to a net-zero economy by 2050. Due to several changes in the structure of the economy following the post 1990 transition, Romania has had massive drops in emissions, being the 4 Member State reducing its emissions the fastest against 1990 in the EU<sup>2</sup>, although it is not on a predictable and sustainable trajectory to net zero by 2050 yet. However, Romania is the country in the South East European or Central East European space with some of the best enabling conditions for the energy transition : a diverse energy mix of which almost 50% of it is already greenhouse gas emissions free, the largest onshore wind farm in the EU and huge RES potential. Yet, Romania continues to be one of the lignite intensive countries in the EU, and despite its lower share of coal in the mix than the rest of region, the required investment for its energy transition are not to be underestimated.

This means that on the European scale, Romanians still pay more than their European counterparts for the costs of this carbon intensive energy system. Romania yet it has the second lowest GDP in the Union and therefore the actual needs of investment for the energy transition are extremely high.

2. EEA Report 06/2019, Annual European Union greenhouse gas inventory 1990-2017 and inventory report 2019, submissions under the UNFCCC and the Kyoto Protocol

According to its own estimates, as presented in the draft National and Energy and Climate Plan submitted by the country to the European Commission, the investment needed for the energy transition between 2021-2030 would amount up to 127 billion Euros<sup>3</sup>. This number has been questioned by NGOs in the country and in fact comes from a national energy strategy which is outdated and therefore in the process of being changed. In a public statement, the country's Minister for Energy at the time estimated the cost of transitioning the power sector by 2030 to be 15-30 bl Euros<sup>4</sup> which seems closer to reality.

This amount takes into account the necessary substantial transformations its energy system would have to undergo such as the modernisation of its grids, reaching the EU targets of the Clean Energy package as well as many other inputs, factors and considerations. This study shows that through a combined channeling of cohesion funding and ETS funding and revenues recycled, this amount is in fact available for the country. However, in order for them to create a comprehensive financial envelope to support a strategic national investment plan over a period of 7-10 years, the country would still need to get its NECP in line with the more ambitious scenarios of the energy transition (as this would increase the amount of climate mainstreaming as well as the value of ETS funds) and actually plan how to use the two tools combined.

## II. The Multi-Annual Financial Budget and climate mainstreaming for Romania

In its proposal for the EU-budget post-2020, the European Commission laid the emphasis on the fact that 1 euro out of every 4 disbursed would go to climate action, in what is called the climate mainstreaming. Even though the EU's climate mainstreaming has had some serious shortcomings as pointed out by the European Court of Auditors in 2016<sup>5</sup>, it is also recognised that its implementation "has led to more, and better-focused, climate action funding" in some key sectors such as cohesion policy. Therefore, this increased target of 25% should be supported and even raised to 40% in order to actually show a clear prioritisation of climate action by the European budget, which an ambitious goal such as reaching the Paris Agreement would require.

Politically, it seems that most Member States agree on the 25% climate

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3. Romania's National Energy and Climate Plan draft 2019, [https://ec.europa.eu/energy/sites/ener/files/documents/ro\\_swd\\_en.pdf](https://ec.europa.eu/energy/sites/ener/files/documents/ro_swd_en.pdf)

4. <https://www.reuters.com/article/romania-energy-strategy-idUSL8N21141Z>

5. <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=39853>

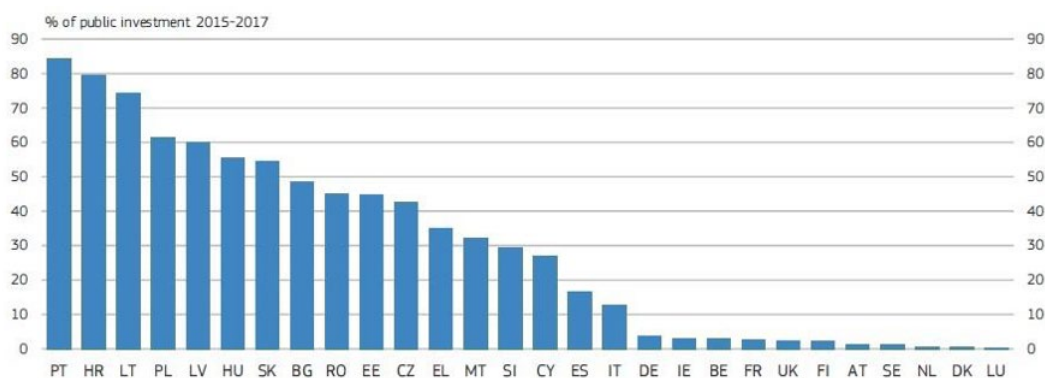
mainstreaming objective, with some Member States seeing it as a minimum and others as a maximum. On 29 November 2019, the Prime Ministers of Latvia and Estonia as well as the President of Lithuania sent a joint letter<sup>6</sup> to the heads of state and government of the EU clearly identifying the next MFF as the “key instrument to deliver climate neutrality” and calling for at least 25% of climate mainstreaming and acknowledging that the investment needs even exceeded this target, “given the intensity of investment necessary in this area over the next decade”.

With a budget of €373 billion for 2021-2027<sup>7</sup>, the future Cohesion Policy will be the biggest investment policy of the EU, accounting for approximately 30% of the total EU budget and covering seven years in the critical decade that will lead us to 2030. The Cohesion Fund and the ERDF are expected to invest at least € 108 billion in climate and environment related projects during this period (2021-2027), more than 30% of the total envelope. As cohesion Policy is an expression of economic solidarity across the different regions of the EU and a proven catalyst in the fight against climate change, its role in shaping the public investments, especially in Central and Eastern Europe, is crucial: on average, cohesion policy represents 41% of all public investment in infrastructure in the EU-13.

In Romania, 44,86% of all public investments between 2015 and 2017 came from cohesion policy.. Therefore, the rules governing the support from cohesion policy in the EU have a major impact on the economic landscape of the recipient countries and create investors certainty on the key economic activities it supports.

FIGURE 1:

### Share of Cohesion Policy funding as % of public infrastructure investments 2015-2017



Sources: Eurostat, DG REGIO

6. [https://www.valitsus.ee/sites/default/files/news-related-files/3b\\_mff\\_climate\\_letter\\_29.11.2019.pdf](https://www.valitsus.ee/sites/default/files/news-related-files/3b_mff_climate_letter_29.11.2019.pdf)

7. European Commission, Multiannual Financial Framework, Annex 2, 2 May 2018, p.1 ([link](#))

Cohesion funds and more generally EU policies have a huge role in driving investments into the low-carbon economy. Romania's strategy for climate-mitigation has been described as "mostly EU-led"<sup>8</sup> in 2015, as the Government did not envision additional or complementary policies to address climate change apart from the EU obligations. It remains clear that the new EU funds support for the 2021-2027 period will also have a tremendous impact on the nature and quality of future investments in the low-carbon economy.

However, cohesion policy is not always used to its full potential. On average, calculations show that while 20% of all spending should have went to climate objective under the budgetary period 2014-2020, only 7,8% of investments realised in Romania thanks to cohesion policy went to actual clean energy projects<sup>9</sup>. As Romania is divided between 7 regions classified as "less-developed" and one "more-developed" region (the Bucharest region), the level of spending into the current objective 4 of cohesion policy "supporting the shift towards a low-carbon economy in all sectors" was set at 12% for the less developed and 20% for the Bucharest region

One of the major points of contention in the post-2020 EU Budget is the size of the cohesion policy and the criteria for allocating each national envelope. Even though Romania was relatively well endowed during the 2014-2020 period, it will not lose from the changes in allocation calculations, as it is supposed to receive on average 8% more from the cohesion policy during the next budget period, from € 25,2 Bn to €27,2 Bn in 2018 prices, possibly leading up to a total of 30 Bn when other factors are accounted for such as inflation and change rates.

According to the latest figures delivered by the Romanian Government, the current cohesion policy allocation proposal for Romania is € 30.60 billion, counted as follows: € 8,3 Bn for the European Social Fund Plus, € 17,3 Bn for the ERDF, and € 4,49 Bn for the Cohesion Fund. According to the mandatory earmarking and cohesion policy calculations, this should mean that at least € 5,19 Bn from the ERDF and € 1,6 Bn from the Cohesion Fund go to climate objectives.

This estimate is reflected by the allocation proposal pushed forward by the Romanian Government, claiming that it will dedicate around € 5,5 Billion for a "greener, carbon free Europe" (see table). This increased amount of resources dedicated to climate action through cohesion policy is obviously a good sign but will have to be checked thoroughly at the level of the implementation of the actual programmes.

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8. Climate's enfants terribles report- Bankwatch, 2014, p.126 ([link](#))

9. Climate Action Network Europe, Negotiating the MFF 2021-2027 : EU budget for higher climate ambition, briefing paper, December 2019, p.7 ([link](#))



Furthermore, the fact that Romania is planning to invest € 5,5 Bn in climate-related activities should not hide the fact that the Government also plans to invest more money in every other policy objective (except for PO 5), showing the clear added value of a mandatory spending target on the green policy objective. This also means that to maximise climate action and make sure that the 25% climate mainstreaming objective is reached, the thematic concentration objective on PO2 should be raised from 30% to 40%.

**TABLE 1:**

### Allocation proposal<sup>10</sup> for each Policy Objective (excluding the amounts allocated for technical assistance)

Proposal	Amount allocated for technical assistance
PO1. A smarter Europe - innovative and smart economic transformation.	€ 5.992 billion
<b>PO2. A greener, low-carbon Europe.</b>	<b>€ 5.459 billion of which, € 3.1 billion allocated to the energy sector*</b>
PO3. A more connected Europe - mobility and regional ICT connectivity.	€ 5.945 billion
PO4. A more social Europe - implementing the European Pillar of Social Rights.	€ 9.673 billion
PO5. Europe closer to citizens – sustainable and integrated development of urban, rural and coastal areas through local initiatives.	€ 1.027 billion

\* according to the latest version of the Romanian NECP

Another issue is that Romania has trouble in finding suitable projects to spend some of its allocated funding. So far under the current period (2014-2020), Romania has an absorption rate of 31%, which means that still 69% of funds will have to be invested during the remaining years of the 2014-2020 programming period.

Most of these shortcomings can be addressed by a transparent and participative programming process: during the better part of 2020, Member States will discuss the main documents governing the use of cohesion policy, namely its partnership agreement and the various operational programmes. An ambitious, transparent and widely consulted programming process would go a long way in ensuring better chances for absorption of the funds, as public participation enables citizens and stakeholders to improve projects by making sure they are adapted to local and regional needs and priorities.

10. after reallocating 5% from the ESF to the ERDF and taking into account the thematic concentration

## To have or not to have a Just Transition

A new and important topic in the climate action and EU budget discussion is the just transition. The Commission proposed on 14 January a Just Transition Mechanism, which would be composed of a fund of € 7,5 Bn called pillar 1, an InvestEU “Just transition” scheme mobilising € 45 Bn (pillar 2), and of a public sector loan facility mobilising Eur 25 to 30 Bn of Investments (pillar 3). Even though the proposed amounts for the whole mechanism (€ 100 Bn) pale in comparison of the proposed ERDF/CF resources (€ 260 Bn), the high political attention around this initiative makes it a key element in the discussions regarding the level of ambition and investment in the net-zero transition in Europe.

So far, out of this 7,5 Bn Just Transition Fund, Romania would receive € 757 million, being the 3rd highest recipient for the fund. Moreover, according to the Commission’s own calculation, Romania would, all pillars combined, benefit from over € 10,11 Bn investments under this scheme. This amount is prospective and would have to be reassessed once the Parliament and Council find a compromise on the Just transition fund as well as on the overall MFF. However, in order to have a just transition, the country must prove that it is, indeed, planning to have a transition to a decarbonised power sector by 2030.

The inter-institutional discussions around this fund should therefore give a clear priority to climate-action and to net-zero development plan, rather than funding harmful activities such as fossil fuels infrastructure; it appears evident that any investment in future stranded assets will make the transition to a net-zero carbon economy all the more difficult. Furthermore, with the nature of grids in the region and Romania having traditionally been a net exporter of electricity (despite the reverse trend in 2019), the accelerated transformation and investment here could bring about benefits for the whole region.

### III. The EU Emissions Trading Scheme as a revenue recycling scheme

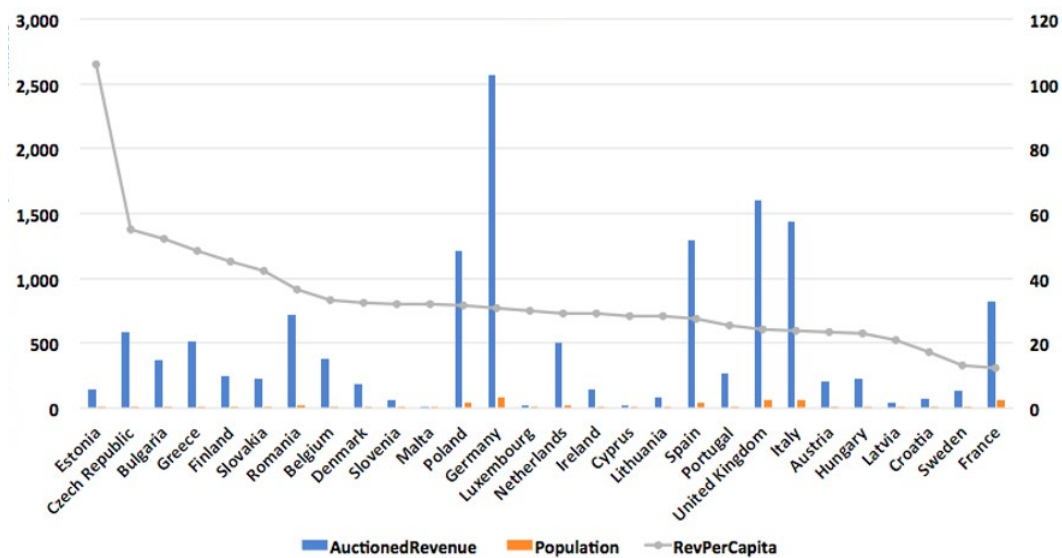
The EU’s carbon market, known as the EU ETS, is not traditionally perceived as a policy tool to alleviate the economic disparity across the EU but rather as the cornerstone climate policy tool to promote cost-effective decarbonisation across the whole European landscape. However, it is the second biggest financial mechanism with which the European Union seeks to pursue the goals of the Paris Agreement while equalising the internal economic diversity within its jurisdiction. In reality, this scheme shifts significant financial flows by first putting a price on carbon and secondly, by creating streams of revenues which are then

either allocated to funds with specialised purposes (i.e. the Innovation Fund, the Modernisation Fund) or go into Member States’ budgets. For fast tracking climate investments, ideally, Member States would need to recycle these auction revenues to support further investments in low carbon technologies.

The discrepancies in funding revenues across the EU are relative to the carbon intensity of the installations in those countries. When taking into account the population of the different Member States and the revenues their respective Governments auctioned through the EU ETS, we can reach an estimate of how much could be retributed to each citizen, per capita. This calculation is relevant in so far as addressing the social cost of carbon in each Member State could actually benefit from the ETS revenues being reinvested back into alleviating the impacts of decarbonisation. Governments could use this lense to scope out the magnitude of impact of their decision to pursue a strategic investment option for the EU ETS revenues. Looking at the year 2018 alone, we see a rather diverse profile. We do, however, see the country in focus here, Romania, at a relative amount of 38 Euros/capita.

FIGURE 2:

ETS revenues per capita per Member State, 2018



Sources: Based on calculations by Sandbag. Emissions data from EUTL, population data from EUROSTAT

In acknowledgement of a need for cohesion and solidarity in a jurisdiction with such high difference in standards of living, in the quality of technology options, the next phase of the EU ETS has several built-in funds and options that aim to boost up the investment possibility of those Member States with a GDP below the EU average.

Looking at our case study, we see that for the next phase of the EU's carbon market lasting from 2021 to 2030, Romania has funding available through the EU ETS scheme, which takes into account its lower level of GDP (second lowest in the EU):

1. A Modernisation Fund comprising of a total of 12% form the overall Fund). The total value of this fund following the country's decision to move most of its 10c allowances to it could range from 2.7 bil. € to 4 bil. € (depending on the value of the price on carbon allowances, in this case from ransing 23€/tCO<sub>2</sub> to 33€/tCO<sub>2</sub>)<sup>11</sup>;
2. A 10c derogation, including for covering emissions resulting from highly carbon intensive district heating (this particular derogation was only granted to Romania and Bulgaria, reflecting their GDP below 30% the EU's average at the moment of negotiations, another plug-in to aid cohesion) - this will amount up to €114 million, following the country's decision from 2019 to move most of its 10c Allowances into the Modernisation Fund described above;
3. A Solidarity transfer provision of extra allowances for designated funds: could range from € 2.5 to € 3.6 Bn.
4. Auctioning Revenues which could range from € 5.4 Bn to € 7.8 Bn for the same price range.

Taking the middle point of all estimates, financial flows available for investment in low carbon technologies, stemming from the EU ETS alone, amount up to approximately € 18 Bn at the price of approximately 28 €/tCO<sub>2</sub>. Most likely the price of allowances will be substantially above this number, with some estimates projecting it almost as double, meaning the available flows would also double. In total we see some solid amounts which will be generated through this scheme which could enable the Member State to make strategic investment decisions and plans.

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11. Using the range between the lowest point reached over 2019 and going up by 10Euros, in line with an average of projections for Phase IV on the amounts presented in a previous Sandbag briefing, <https://sandbag.org.uk/project/chooseyourfunds/>

## BOX 2

**Summary of available funding for climate in cohesion policy for Romania:**

- € 5.5 Bn out of the Policy Objective 2 (under a 30% earmarking scenario)
- € 757 M out of the Just Transition Fund
- Possible € 10,11 Bn mobilised under the Just Transition Mechanism

**€ 16,3 Bn**

ETS (approximation based on a conservative estimate for the range of EUA prices):

**€ 18 Bn**

Other instruments such as Connecting Europe Facility, InvestEU or LIFE+ programme could also give financial support to Romania's clean energy transition but are not split into national envelopes.

Moreover, on 14 January, the European Commission unveiled its communication for an Sustainable Energy investment Plan, renamed soon after the "European Green Deal Investment Plan". This plan aims at mobilising at least EUR 1 trillion of investments over the upcoming decade. Apart from the 25% of the MFF resources going to climate action, the plan foresees the contribution of other financial instruments such as InvestEU and the EIB which having recently changed its lending criteria away from fossil fuels, will have to reinvest in other priority technology development areas for Member States.

By providing an EU budget guarantee to partially cover the risk of financing and investment operations, the InvestEU programme and 13 other EU financial instruments will mobilise approximately EUR 195 billion of climate investment from 2021 until 2027, i.e. close to EUR 28 billion per year and 280 billion over a decade. For the duration of the Sustainable Europe Investment Plan over a decade, the EIB is also expected to finance around EUR 608 billion of climate investments within the EU and outside.

That would mean close to € 888 Bn over 10 years in the sustainable investment plan, triggered by the EU budget. However, unlike the EU Budget, these amounts are EU-wide estimates of the possible private investment to be mobilised through EU budget guarantees. Moreover it is difficult to assess how much would go to

Romania, given the poor record of the EFSI in mobilising private investments in Eastern Europe.<sup>12</sup>

## Conclusion

### **Climate emergency - financial redistribution, a reinvention of Europe, it emphasises**

It appears clear that national priorities can be linked to the wider EU ones : infrastructure to the climate spending, retraining / reskilling to education, etc.

But this challenge is also an opportunity: Romania must take advantage of these funds as the priorities will be different over the following 7 years and set in motion the engine and seek to attract investment going forward.

Moreover, the European Green Deal is widely endorsed at EU level but will only deliver if the EU Budget is focused on the right priorities, and if Member States commit to ambitious spending to support this new initiative. Otherwise, the MFF will support business as usual activities and harmful projects for another seven years. The level of investment is important, but the quality of investment is also a major factor; good quality projects will go a long way and will be extremely helpful to transition to a zero-carbon economy.

It also appear to be the case that the estimate for the investment gap for the power sector decarbonisation up to 2030 in a country like Romania, could in fact be financed through a smart utilisation of ETS revenues and cohesion funding in a comprehensive strategic and synergic way. An ambitious NECP could be the country's strategic investment plan in that regard and an increase in the share of climat mainstreaming or of the ETS carbon price will only increase the amounts available.

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12. <https://bankwatch.org/wp-content/uploads/2019/09/EFSI-final.pdf>

## Policy recommendations:

1. Member States should raise the climate mainstreaming target to 40% of the total MFF expenditure and increase thematic concentration in cohesion policy to at least 40% on PO2 in all regions;
2. Romania should seek to use the revenues from auctioning on the EU ETS towards supporting further investments, therefore recycling its revenues and amplifying the investment potential;
3. When it comes to having the EU delivering on climate action, Romania should focus on a thorough and consistent planning of the next generation of cohesion policy funding: partnership agreements and operational programmes should be properly and widely consulted with all relevant stakeholders and give clear priority to climate action.
4. Finally, Romania should aim to maximise its investment attractiveness by creating a strategic investment plan to span over a period of 7-10 years, remaining resilient to further political changes; its NECP could in this perspective act as an investment portfolio.

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