

Fixing the Commission's innovation fixation: three recommendations for the overhaul of the Innovation Fund

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Joint feedback from Carbon Market Watch and Sandbag Climate Campaign

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The EU's Innovation Fund, launched in 2018, is the EU's programme for funding cutting-edge low-carbon technologies. To be eligible, projects must be, [according to the European Commission](#), highly innovative, cost-efficient, mature, scalable, and have a significant emission reduction potential. The Innovation Fund is financed using revenues from the Emissions Trading System (ETS), under which certain sectors have to buy emission permits (allowances) in order to be allowed to pollute.

The Innovation Fund is currently being overhauled to reflect recent changes to the ETS. Notably, the [compromise agreement reached in December 2022](#) mandates the integration of the Innovation Fund rules to allocate financial support through a competitive bidding mechanism referred to as 'contracts'. This mechanism is intended to complement the current allocation method, relying exclusively on grants. In addition to the introduction of competitive bidding, the ongoing overhaul of the Innovation Fund is also expected to include provisions to clarify the evaluation criteria for grants and to define medium-scale projects as a distinct category. Lastly, the reform introduces the concept of 'auction-as-a-service', which extends the forthcoming competitive bidding mechanisms to Member States interested in allocating additional resources within their countries.

This article is based on joint feedback submitted to the European Commission's Innovation Fund Expert Group, which is responsible for the revision, by Sandbag and Carbon Market Watch.

Outdated benchmarks

The Innovation Fund is supposed to fund highly innovative and state-of-the-art projects with Deep greenhouse gas (GHG) emission reduction potential. However, the draft revision of the Delegated Act presented by the Innovation Fund Expert Group risks instead **awarding grants to projects with only marginal abatement potential** because of unambitious reference points.

The criterion on GHG emission avoidance is based on the EU ETS benchmarks which identify the level of free allowances that can be allocated to energy-intensive industries to protect installations from the risk of carbon leakage. However, the benchmarks are based on emission intensity levels for the 10% lowest-emitting plants in 2016-17 and can be corrected by a maximum of 1.6% (until 2025) and 2.5% as of 2026, so for some sectors they are much higher than the best and most efficient available technologies already installed in the EU. This is despite the fact that this emission intensity criterion is being applied to projects up to 17 years into the future¹. As a result, these outdated benchmarks risk leading to funding being awarded to projects that will only result in minimal emission reduction (if any). The Commission therefore needs to update these reference points as part of its overhaul of the Innovation Fund so that support ends up benefitting the cleanest and most innovative projects.

Scalability ≠ circularity

The amended ETS directive commands that projects supported by the Innovation Fund “contribute to energy and resource savings”, “with a view to their broad roll-out across the EU” (Article 10a(8)), yet the degree of resource saving is only covered by the IF criteria in optional ways:

- as part of the “degree of innovation” criteria; the fact that a project also saves resources can be considered a “plus”, and
- in the “scalability” criterion, which notes that resource-saving qualities may contribute positively to the score.

Resource-saving should not be optional but a requirement for IF support, as it is key to the scalability of projects. Instead of having circularity covered by optional sub-criteria, **resource saving should be explicitly assessed in a mandatory criterion** with equal importance as a project’s degree of innovation.

Additionally, in the current “scalability” criteria, scalability is rated at local, sector and economy-wide level in equal proportions. This may obscure unsustainable practices, as projects that are unsustainable at economy scale (e.g. power-to-hydrogen-to-power without storage; hydrogen for domestic heating...) might be considered scalable for the local economy or even the sector, and therefore still be given a decent score.

Our recommendations in brief:

- The Commission should update the outdated reference points so that support goes to projects with the highest emission-reduction potential.
- Resources-saving is a key indicator of a project’s scalability. It should therefore be a mandatory criterion for IF support, similar to a project’s degree of innovation.
- To know whether a project is truly sustainable, it is most relevant whether it is scalable on an economy-wide level. This should therefore be the decisive scalability criterion, rather than being rated with equal weighting to scalability at local and sector-wide levels.

What happens now

The reforms to the Innovation Fund will be enacted through a Delegated Act, which the European Commission expects to adopt by mid-July. The Commission aims to secure approval from both the European Parliament and the Council of the EU by mid-September at the latest, it hopes to set up the first auction under its proposed [European Hydrogen Bank](#) this autumn.