INTERNATIONAL SUSTAINABLE FINANCE CENTRE

Pursuing RePowerEU

Challenges and Opportunities

March 2022

Pursuing RePowerEU:
Challenges and Opportunities

Based on our analysis, we recommend eight priorities for EU Member States:

Strategic and practical priorities to make energy independence a reality

1. Creation of a new EU-wide fiscal framework
2. Focus on what is needed for a successful RePowerEU

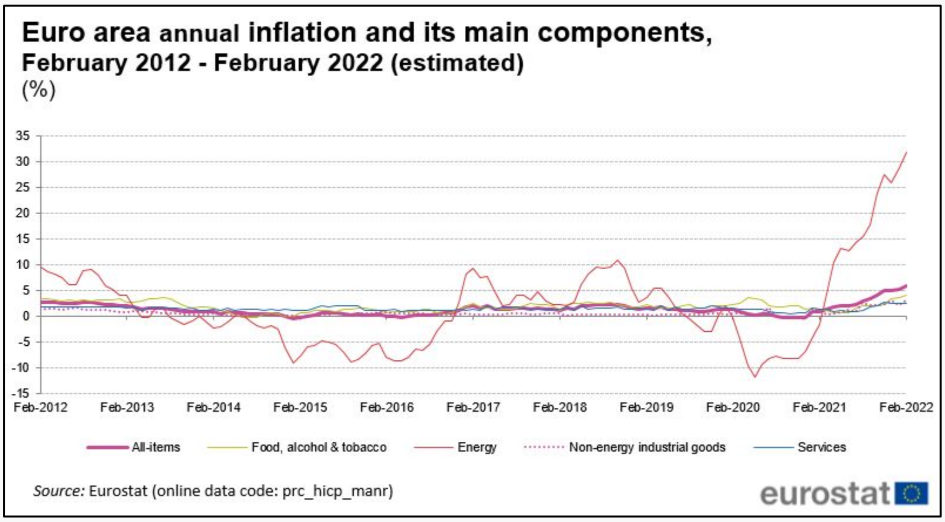
National and regional level priorities

1. Signal intention and offer longer term certainty for business and finance
2. Increasing development and deployment of renewable energy sources
3. Improved energy efficiency and renovation of existing building stock
4. Reduction of energy consumption and energy saving campaigns
5. Learn to mobilise private capital
6. Prioritise policy alignment to incentivise decarbonisation & productive investments

Background

In March, the European Commission announced unprecedented actions to double down on the EU's decoupling from Russian gas imports. The ambitious plan, called RePowerEU, intends to cut back gas imports from Russia by two-thirds this year, and to accelerate the full energy transition envisaged in the European Green Deal before the initial deadline.

We welcome the fast-moving approach the Commission has taken, but we worry about the practicalities and the implementation of the ambitious plans. The energy goals will not be within easy reach for some of the Central and Eastern European (CEE) countries, putting additional pressure on their governments, policymakers, and budgets. To make the RePowerEU plan work, the fiscal framework, EU-level guarantees and supporting policy instruments need to factor in the disparities across the EU Member States. Not only will the coal dependent, fossil intensive CEE countries have a harder time to switch from Russian imports, but the worsening of trade terms, growing inflation, and the proximity of the Ukrainian conflict, all pose a serious threat to their economic outlook.



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The Commission needs to streamline funding to CEE as the costs of transition in these economies will be large. It also needs to ensure adequate technical assistance and implementation. The national governments, on their part, need to prioritise funding projects that improve energy independence and efficiency, while offering support to businesses that have concrete plans to improve their sustainability performance.

The initial plans also foreshadow energy price regulation to mitigate the energy price spike's effect on households and businesses. With subsidy schemes in the offing, the worry is that the front-loaded diversification will exacerbate the inflation problem these countries are already grappling with and can stifle the economic growth in the short run.

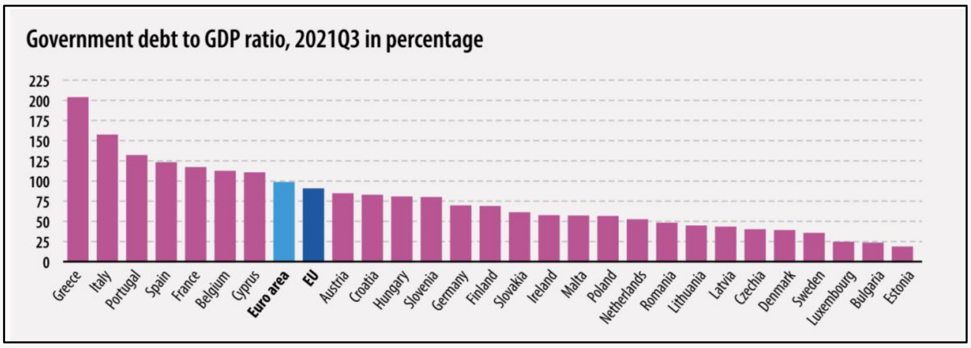
Strategic and practical priorities to make energy independence a reality

With limited or no access to alternative gas pipelines for most CEE countries, the only viable option to reduce the dependency on Russian fossil fuels can come from an accelerated development of clean energy sources in the region, coupled with improved energy efficiency and thus reduced energy consumption. This will require a tremendous amount of new capital, both public and private, being efficiently channelled to large-scale renewable energy projects supported by coherent and cross-sectoral policy effort focused on energy efficiency and reducing energy consumption.

1. Creation of a new EU-wide fiscal framework

When it comes to the unprecedented cutting of Russian gas, there is a palpable East-West division. Western Europe has an easier way out due to its access to liquified natural gas (LNG). Central Europe, however, faces a grave situation. Barring easy access to alternative energy commodities, the short-term adjustment will be costly and demand side restrictions might be required of these countries. Not only does the price shock inflict economic damage on the region, but it is also likely to divert capital investment as risk premiums will increase and sentiment could sour.

The immediate question the European Commission faces is how to set a fiscal framework in place that addresses the disparities between Member States, and that best achieves the necessary redistribution. We see an urgent need for an overarching fiscal framework that reckons with the immediate costs of logistical difficulties for the landlocked members and that of the prompt substitution. To add to the policymakers' woes, the fiscal frameworks need to find space to mitigate the ripple effect of the outsized energy price shocks that the transition will create.



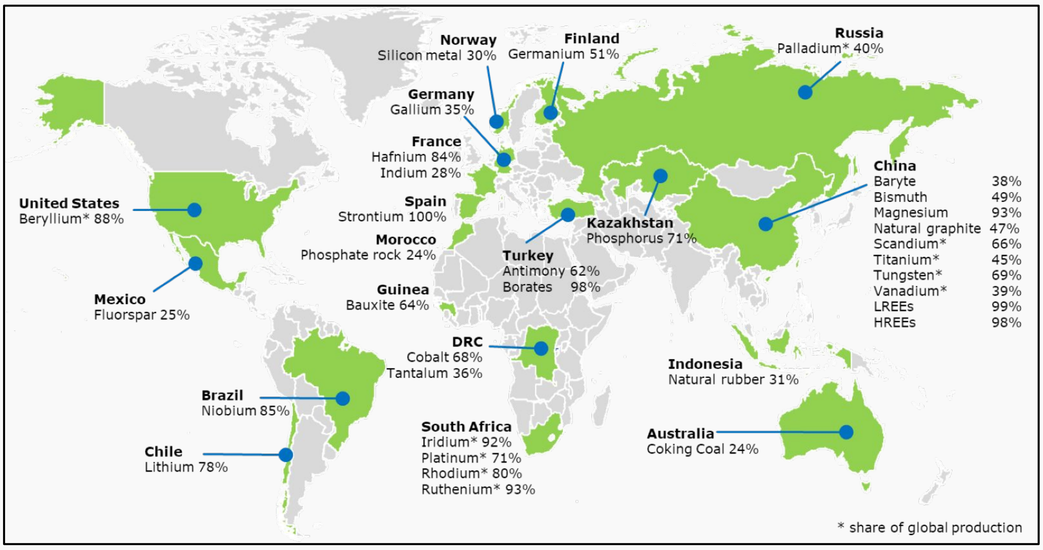
Source: *Eurostat*

Europe is treading a fine line between a myopic focus on short-term replacement and long-term low-carbon solutions. While devising a short-term funding strategy, the Commission needs to make sure that investments into deep decarbonisation are not crowded out. One option could be a ‘green golden rule’, as suggested by the Brussels think tank Bruegel experts, which would exclude net green investment from the fiscal indicators used to measure fiscal rule compliance. This would increase the flexibility of the fiscal framework and support investment into decarbonisation, but it would require clear guidelines of what ‘green’ is. Unless the EU Taxonomy excludes gas, it cannot be used as such standard for sustainable economic activities for investment as it would go against the objectives of the EU’s RePowerEU plan.

Currently, the EU is sending more money than ever to Russia for its oil and gas due to a huge price spike. This not only helps Russia withstand the sanctions, but it also enables it to carry on the attack on Ukraine. In immediate terms, it is key to address the shock that can arise from Russia suddenly stopping gas exports. This can be done by introducing a temporary suspension of the EU energy market, along with rationing and price controls to avoid damaging the EU’s energy transition plans through increased reliance on energy from fossil fuels, such as coal production.

2. Focus on what is needed for a successful RePowerEU

The RePowerEU plan faces multiple challenges that it will need to overcome for its successful implementation. One is the timing: the plan’s intended timeline coincides with a potential rise in commodity prices, grain, and food shortage in some regions, rising inflation and growing national deficits. In addition, to scale up renewable energy sources (RES), the EU will need reliable and secure access to critical minerals and rare earth materials, most of which are located outside Europe.



Source: European Commission

This will mean that the EU internal and external policies will need greater alignment, prioritising climate diplomacy and relationship building with countries whose cooperation is critical for the EU’s key supply chains, and thus the success of European energy transition and decarbonisation efforts.

National and regional level priorities

1. Signal intention and offer longer term certainty for business and finance

One of the most important levers for change is the governments' capacity to signal the direction of travel. Governments in the region need to adopt a clear strategic direction that outlines the priority focus areas for strategic development. Clear communication about expectations and policy frameworks would enable businesses and investors to make longer-term plans and support more strategic investment.

2. Increasing development and deployment of RES

The speed of RES development and the policy frameworks stimulating the investments in clean energy vary across the CEE region. With no gas available for the transition process from coal to renewable power, the efforts will need to be urgently scaled up, which will require streamlining of government financial support and signals to motivate more private capital and grow private capital markets. Imported gas was earmarked to have a crucial role in the transition in the CEE countries (e.g. Poland, Czechia, Slovakia) as a transitional fuel in the shift to clean energy. These countries will struggle to phase out coal and meet the growing energy demand without gas, so transition alternatives will need to be explored, for example, green hydrogen.

3. Improved energy efficiency and renovation of existing building stock

In the EU, buildings are responsible for 36% of the emissions and 40% of energy consumption. Renovating existing buildings with focus on insulation and prevention of heat loss, is one of most efficient ways to reduce the consumption of energy used for heating, especially in the CEE urban areas dependent on gas. A large share of final gas consumption in the region is households and private sector, which will need structural reforms of heating systems.

4. Reduction of energy consumption and Energy saving campaigns

A call for responsible energy consumption is needed at all levels of society and business. At the same time, priority must be given to the creation of an enabling and modernised electricity infrastructure (flexible electricity grids, smart meters, incentives for prosumerism, batteries, electricity storage solutions, pumped storage, and demand-side flexibility). The necessity of decreased energy consumption and savings effort will need to be clearly communicated to the public and to business. Nationwide campaigns focused on education of consumers need to be deployed as soon as possible to inform about the best practices as well as available opportunities for households and businesses to improve their energy efficiency and obtain financing for energy saving solutions. We welcome timely analysis from Hnuti Duha, including the impressive campaign to encourage people to turn down the heating in their homes by 3 degrees.

It will be key to engage with and support the capacity of cities and municipalities to drive the energy efficiency and energy decarbonisation efforts. Cities and municipalities can use EU funding and, in some cases, even issue their own debt instruments such as transition or green bonds to finance energy savings in heating systems and buildings. This could also alleviate the future burden on budgets and on consumers.

5. Learn to mobilise private capital

Private capital needed to accelerate the transition will face a variety of growing obstacles and risks unique to the CEE region. For one, the negative economic impacts of the sudden loss of large energy source, which the region relied upon for the transition period, will introduce new investment risks and uncertainty in the coming months and years. Most countries of the region are geographically located in the proximity of the conflict, which may further decrease the credit rating and attractiveness for private investors, who will look to shift their capital to more stable regions. Moreover, the heavy economic impacts caused by the pandemic are still unfolding, further contributing to financial instability and substantial inflation.

While there are exceptions across the region, the capital markets in the CEE are relatively underdeveloped compared to the West, with limited capacity to leverage new financial instruments to obtain private financing for expansion of clean energy, such as green or sustainability-linked bonds. This needs to change. The CEE governments need to have a comprehensive and complementary approach across different sectors and policy areas to create incentives and mitigate risks, thus enabling the deployment of more private capital. This can take the shape of government guarantee schemes, and support for building a pipeline of projects that are bankable and aligned with national and regional priorities.

Greater use of funding by the European Investment Bank (EIB) going forward should be prioritised. CEE countries should move from an over-reliance on grants to accessing EIB loans for projects that can have an amplifier effect on job creation or energy savings.

6. Prioritise policy alignment to incentivise decarbonisation & productive investments

To ensure future competitiveness and economic growth that will be key for addressing budget deficits and inflationary pressures, it will be key for governments to:

- Improve policies and provide incentives to motivate channelling capital to solutions,
- Develop capital markets - pool risk and offer guarantees to attract private capital
- Ensure regulation and supervision rewards long-term investing

Improved policy frameworks, for example, are needed for accelerating development and building of RES. One of the key drivers for scaling up of renewable energy solutions would be reduced permission process and bureaucracy, that would allow the development and installation of solar capacities on buildings. This should go hand in hand with support and technical assistance for municipalities, and reduction whenever possible of the administrative burden for accessing public or EU funding.

Increased and improved communication and technical support for implementation of new EU sustainable finance policies such as SFDR (for financial institutions) and CSRD (for companies) can help financial sector actors to channel money to projects and businesses that are aligned with a country's sustainability and energy goals and can help drive an improvement in business models (for example, supporting ones that are improving energy efficiency or resource use).

Conclusion

While all crises are difficult and have negative effects, they can also serve to focus minds and efforts, and to pivot to a better direction of travel. The EU and the CEE countries in particular have a great opportunity to rethink their policy frameworks and priorities. CEE governments need to work much closer with key stakeholders and experts in sustainable finance, project design and creation, public-private partnerships, etc., all of which can lead to tangible improvements in the impact on the real economy.

It is time for the CEE governments to take full responsibility for their countries' economic trajectories, and ensure that policies and incentive structures support decarbonisation efforts, renewable energy development, and long-term investment into critical infrastructure and R&D. We welcome the Visegrad 4 statement from 8 March about the dedication to the reduction of the countries' dependence on fossil fuels from Russia, but we urge for even more ambition: working towards removing all dependency on all fossil fuels. With political will, a lot of positive change for future economic competitiveness can be achieved, and political capital gained: the public will appreciate cleaner air, cheaper energy, and more modern infrastructure. It will also appreciate feeling more secure, with less dependency on the capital and energy from a hostile regime nearby.

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The International Sustainable Finance Centre (ISFC) is an independent, apolitical and impact-driven non-profit think tank whose aim is to carry out in-depth research on sustainable finance topics. The Centre uses expert insight and practical policy solutions to inform public debate and policymaking on sustainable finance, while also helping to build local expertise, networks and capacity on key topics, which include the EU's Green Deal, its Sustainable Finance Agenda and its post-COVID19 recovery packages.