



An inclusive Social Climate Fund for the just transition

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The *just transition* will not be *just* if it is not *inclusive*. Currently, one in five Europeans are at risk of poverty or social exclusion¹. “*To leave no one behind*”² implies taking extra care of the most vulnerable groups in the energy transition. Vulnerable citizens and families are more likely to have the least resources to face climate change, both financially, to move away from fossil-fuels, and politically, to have their voices heard in policymaking³. The Social Climate Fund (SCF) proposed by the European Commission in July 2021 is an unprecedented opportunity to fill this financial and political gap. The SCF has the potential to support access to essential energy and mobility services⁴ for vulnerable citizens across the European Union (EU). It would serve as a complement to the Just Transition Mechanism that primarily is dedicated to mitigating social and employment impacts in coal dependent regions.

However, the current proposal offers insufficient guarantees for fulfilling expectations on social justice, decarbonisation, and more inclusive governance. Building on our previous brief on the Social Climate Fund⁵ that highlighted the need to decouple the SCF from the “ETS2” (the proposed Emissions Trading System on heating and road transportation), this brief outlines the key conditions to ensure that the SCF delivers a just transition. First, we present the main features of the Commission’s SCF proposal, and thereafter we turn to highlight why social acceptability should be the guiding principle of the SCF. This implies: (1) leaving enough room for social compensation targeted at the most vulnerable in the transition, which will be indispensable in some national contexts; (2) financing salient decarbonisation programmes targeted to the most vulnerable; and (3) implementing inclusive consultation, decision-making, and monitoring processes in the governance of the fund.

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I • The Commission's proposal for a Social Climate Fund, a fixed budget with centralised governance

The official objective of the SCF is to counterbalance the expected social impacts of the ETS2 for vulnerable citizens and micro-enterprises. The financial burden of the ETS2 is expected to be unevenly distributed among EU citizens⁶. The costs would disproportionately affect families that already suffer from energy poverty⁷, and the most vulnerable who spend larger parts of their income on energy and transport, i.e., low-income families living in the worst-performing buildings and/or in rural areas⁸. If affordable alternatives to fossil fuel-based heating or transportation are not offered to vulnerable families, they will be left with no other option than to reduce their consumption below basic needs⁹ or cut down on other expenses, such as food¹⁰. **The ETS2, as it is currently proposed, would be a socially regressive policy that however could be turned progressive with the SCF.** The rationale for the new EU fund is to provide Member States with financial support to mitigate the impacts of the ETS2. To this end, the Commission suggests temporary income support (i.e., social compensation in the face of rising fossil fuel prices) and green investments to decarbonize heating and transportation.

In terms of funding, the current proposal includes a fixed amount of €10bn/year¹¹ from the EU budget, which will not vary with the carbon price. The SCF would be financed by a new Own Resource in the EU budget, for an amount corresponding to 25% of expected ETS2 revenues, based on a very conservative price hypothesis¹². This has several consequences. First, contrary to existing funds associated with the ETS1 (i.e., the Innovation Fund and the Modernisation Fund), the SCF would not see its budget grow thanks to a rising carbon price. If included as part of the EU budget, the size of the SCF would be fixed at €10bn/year on average over 2025-2032. Second, the Commission's proposal requires an amendment to the EU budget for 2025-2027¹³ and the creation of a new Own Resource for the EU that would be based on 25% of ETS revenues (1 and 2)

but capped at 15b€/year¹⁴. This new Own Resource needs unanimous approval of all 27 Member States in the Council, which is famously hard to achieve.

As for the governance of the Fund, the current proposal is based on a model of centralised governance between the European Commission and the Member States. The proposed SCF governance model is copied from the Recovery and Resilience Facility Regulation (RRF). Member States are required to submit Social Climate Plans (SCPs) for assessment and approval by the Commission to access SCF funding¹⁵. They will co-finance at least 50% of their SCPs –and are encouraged to use national revenues from the ETS for that purpose. Payments will be authorised by the Commission based on Member States' satisfactory progress in implementing the validated SCPs. Yet, in numerous Member States the development of national plans for the RRF were heavily criticised for a lack of consultation with relevant implementing stakeholders¹⁶ (e.g., local and regional authorities, social partners, and civil society actors). By copying the governance design of the RRF, the Commission risks replicating these flaws in the SCF.

The SCPs will outline the measures and investments that Member States intend to implement to reduce the burden for vulnerable groups. The SCPs will also include assessments of ETS2 price increases' likely effects on households and micro-enterprises, and based on this analysis, identify the most vulnerable groups. The Commission suggests that temporary income support measures are subject to specific justification¹⁷. Furthermore, the SCPs will set out milestones, targets, and timetables for the implementation of planned measures and investments, as well as associated costs.

II • Guidelines for a bigger and a more inclusive design of the Social Climate Fund

The ETS2 is a high-risk low-reward policy¹⁸ that should be abandoned if deep renovation and affordable clean mobility is not

massively scaled-up. **There are enough new revenues from the ETS1 to finance a €10bn/year Social Climate Fund¹⁹.** However, if the European Parliament and the Council decide to go ahead with the ETS2, the SCF will have to address the associated challenges of social acceptability.

Turning a socially regressive EU carbon price on heating and road transport (ETS2) into a progressive policy instrument is challenging, but possible. It all depends on revenue use. Progressive revenue use would increase the social acceptability of the instrument²⁰. The remainder of this section highlights key design elements that would help to ensure such revenue use.

I APPROPRIATE FINANCIAL SUPPORT

Exposure and vulnerability to the EU carbon price will highly depend on income-level²¹. An increasing carbon price would take up a larger share of the disposable income for low-income households, particularly in low-income countries with a high reliance on fossil fuels. Without counterbalancing measures, it may worsen existing energy poverty. As an illustration, the 20% lowest-income households in Bulgaria earn less than 2 900€ per year²² and one in four households face energy poverty²³. In Poland, the 20% lowest-income households make less than 5 900€ per year²⁴ and coal represents 44% of the residential heating mix²⁵. The SCF should foster both intra- and inter-Member States equity.

If the ETS2 is adopted, 100% of its revenues should be earmarked for the just transition. The social acceptability of carbon taxes are stronger when revenues are fully spent on green investments (e.g., subsidies for the deep renovation of buildings where energy poor families live) and social compensation (e.g., lump-sum payments in the form of an ‘energy-cheque’)²⁶. The preferred mix between green investments and social compensation will heavily depend on the national context and political choices.

If the ETS2 is adopted, highly visible and progressive social compensation is likely to be a key element of social acceptability

in many Member States. Contrary to green investment, income support is a short-term measure that does not directly lead to structural change away from fossil fuels. As such, it risks being disregarded by climate-focused policymakers and stakeholders. However, it is an effective measure to counter the immediate regressive effects of carbon prices and can lead to a net progressive effect of the overall policy. In France, following the Yellow Vests Crisis, researchers²⁷ have advocated for a progressive “Ecological Transition Premium” targeted at the 30-60% lowest-income households. In this scenario, up to 70% of carbon tax revenues would be spent on social compensation in the first years, then gradually evolve towards a 50/50 split between targeted social compensation and green investment in 2030. Prominent economists such as Nicholas Stern and Ottmar Edenhofer have confirmed that in the face of low carbon price acceptability, traditional economic lessons on efficiency should be secondary to the challenge of social acceptability²⁸.

If the ETS2 is adopted, the decarbonisation effect of the SCF needs to be even more visible to citizens²⁹, especially to the most vulnerable. Financing green investment programmes will improve social acceptability overall, but progressivity can only be achieved if building renovation and low-carbon mobility projects are effectively targeting vulnerable citizens who struggle to move away from inefficient and fossil-fuel based heating and transportation. For example, the required public investments to achieve the European Renovation Wave³⁰ of the building stock amount to €90bn/year until 2030, with higher subsidy levels in lower-income Member States³¹, and for lower-income families. In this respect, the SCF could introduce differentiated co-financing rates (instead of the proposed flat rate of 50% for all Member States) depending on national income-levels. The SCF has the potential to significantly reduce the funding gap for the building and mobility transition for the most vulnerable, and thus turning the Commission’s just transition talk into tangible action.

I THE DEMOCRATIC CHALLENGE OF THE JUST TRANSITION

If the ETS2 is adopted, deciding upon revenue use and SCF spending will be an even more important political issue. The appropriate mix between social compensation and green investment, the selection of measures and investments, as well as the definition of vulnerable groups will, as previously noted, depend on regional and local contexts, and should be based on citizens' everyday lives, needs and experiences. **If the SCF governance is left to national governments and the Commission, there is a substantial risk that the SCF will miss its objective to finance a just transition³².**

The Commission is aware of the broader democratic challenge associated with the just energy transition. Despite lacking provisions in the SCF proposal last July, the Commission redeemed itself in the December 2021 proposal for a Council recommendation on the social aspects of the transition³³. In the proposal Member States are invited to “*give an active role to regional and local authorities, given their proximity to citizens and local businesses, in the implementation and monitoring of fair transition policies*” and “*empower and enable people, civil society and stakeholders, (...), with a view to their participation in policy design and implementation, also by making use of new participatory models involving people in vulnerable situations*”. **The SCF is an opportunity for the EU to support Member States in this regard,** and we encourage the European Parliament and the Council to update the SCF governance model according to the Commission's latest recommendations.

As emphasised by the Commission, democratic and inclusive governance are highly desirable features of the just transition. If the SCF governance model incorporates the interests of affected citizens and stakeholders, its legitimacy and the legitimacy of broader EU climate policies could be strengthened. This could be done by different types of complementary measures, innovative to diverging degrees, which would allow for co-creation of policy and decision-making. For example, by setting

up participatory processes where citizens themselves can build and voice their opinions, or by including a wider range of stakeholders in the process, e.g., civil society actors that have both knowledge about vulnerable publics and the capacity to understand and voice local opinions and expectations. Responsiveness to the experiences, interests and needs of the most vulnerable groups should be given extra care. This would in turn reinforce the policy coherence, effectiveness, visibility, and overall legitimacy³⁴ of the SCPs in tackling climate injustice.

The SCF regulation could additionally take inspiration from existing multi-level governance models implemented in EU Cohesion Policy. The Partnership Principle³⁵ and the Code of Conduct on Partnerships set requirements and good practices for the involvement of regional and local authorities and all relevant stakeholders (for example environmental authorities, social partners, and civil society organisations) in designing the investment pipelines for the Cohesion Funds³⁶. Assessments of the Partnership Principle have showed that implementation is slowly improving, but that the mobilisation of relevant stakeholders remains a key challenge to reach full potential³⁷. Among other things, a lack of institutional capacity among stakeholders has been identified as an important barrier³⁸.

III • Recommendations

Ensuring synergies between social justice and climate efficiency is a highly political challenge that primarily will be dealt with at the national level through the SCPs. As proposed, the SCF regulation offers insufficient guarantees that national SCPs will translate into progressive revenue use with strong social acceptability.

I STRENGTHENING SOCIAL JUSTICE

- If the ETS2 is adopted, the European Parliament and the Council should ensure that **100% of the ETS2 revenues are earmarked for the just transition.** The easiest way to achieve this would be to use the ETS directive to directly allocate ETS2 allowances to the Social Climate Fund

(either allocating 100% to the SCF, or 50% for the SCF and 50% for Member States to finance their SCPs). The SCF would be considered as an externally assigned revenue and would not be financed by the EU budget. This would allow the financial resources of the SCF to follow ETS price variations.

- The European Parliament and the Council should amend the SCF regulation to **increase inter-Member States fairness by setting differentiated co-financing requirements** depending on the income level of the Member State. 50% co-financing for all Member States is unfair and risks disincentivising ambitious SCPs in low-income Member States.
- The European Parliament and the Council should amend the SCF regulation to mandate that SCPs include **energy and transport poverty reduction objectives** with milestones and timetables.

I STRENGTHENING DEMOCRACY

Re-designing the governance of the SCF towards a **more inclusive and democratic model** will be key to deliver **effective, legitimate, and coherent** policy actions for a just transition across the EU. The European Parliament and the Council should amend the SCF regulation to:

- Include the Partnership Principle as a guiding principle to draft and implement the SCPs, and **include mandatory involvement of national parliaments, local and regional authorities in the drafting, approval, and monitoring processes**, as co-implementers of the SCPs.
- Include the *assessment of the appropriate involvement of local and regional authorities and implementation of the Partnership Principle* as a criterion for SCPs validation and funds disbursement at the EU level.
- **Earmark a share of the SCF (indicative 2%) for capacity building of local and regional authorities** to support their engagement

in drafting SCPs and ensure smooth implementation. **A broader set of stakeholders and projects could also be eligible for this funding**, such as capacity building initiatives by **civil society organisations**, especially those working with the most vulnerable citizens, **technical assistance and funding to set up inclusive consultation processes, innovative deliberation or direct democracy projects** to strengthen public participation, with special care in involving vulnerable citizens (e.g. citizen assemblies, online discussion forums for citizens and civil society organisations, etc.)³⁹, thus also raising public awareness about the European SCF.

- **Support and reward pilot projects aimed at inclusive SCP decision-making and monitoring processes**, including public participation, as well as outstanding implementation of the Partnership Principle. It could take the form of a financial premium (for example a higher co-financing rate from the SCF) granted to Member States whose SCPs display a prominent level of inclusiveness in the drafting and monitoring process⁴⁰.
- Mandate that all the **documents sent to the European Commission for validation and monitoring of the SCPs are also publicly available in at least one of the national languages**, for the purpose of transparency and accountability towards all non-national government stakeholders.
- **If the SCF is not included in the EU budget and financed as an externally assigned revenue⁴¹:**
 - mandate that **SCP validation involves the European Parliament**
 - mandate that **SCPs monitoring involves the European Parliament**, in a similar vein to the Recovery and Resilience Fund set-up with the Recovery and Resilience Dialogue⁴²;
 - **entrust the European Court of Auditors and European Anti-Fraud Office to monitor SCF spending**, considering both climate and social objectives. •

• End notes

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- 40 A list of possibilities could be included, such as : the creation of an independent committee (or involvement of an existing appropriate body) gathering representatives from public agencies, and relevant civil society organizations, as well as social partners, with the role to make propositions to public authorities on SCP content and implementation; participative platforms with moderators where citizens can express their views, fears, ideas, knowledge and experiences on climate change and climate policy; and other participative platforms specifically dedicated to organized actors like social partners, NGOs, local authorities, to facilitate the analysis of the implementation of the SCPs
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