RAMPING UP FINANCIAL SUPPORT FOR DECARBONISATION INVESTMENTS

Transforming the ETS innovation fund and creating a cement decarbonisation fund

November 2024

Executive Summary

The next 10-15 years are critical for the deployment of net zero technologies and their scaling up. As highlighted in the Draghi report on the future of European competitiveness, large parts of industrial sectors' decarbonisation investments lack today a clear business case. Public support is therefore key to de-risk these investments. CEMBUREAU makes essentially three recommendations in this respect:

- The EU ETS Innovation Fund should be turned into a Cleantech Deployment fund to strengthen its ability to support the deployment of net zero technologies and address the risks taken by 'first movers'.
- Crucially, following the recommendations of the Draghi report on the earmarking of ETS revenues, a 'cement decarbonisation fund' must be created, re-using the revenues that the EU cement sector will bring through the EU ETS to support large-scale decarbonisation projects happening in the sector.
- Policymakers should ensure that 100% of ETS Revenues are spent on climate. Furthermore, national state aid rules and European funding instruments should be better coordinated on eligibility, scope (CAPEX & OPEX) and timing through the creation of a "one-stop-shop" project submission procedure.

These suggestions build on the existing legislation ETS-related legislation and could be implemented as part of the upcoming Clean Industrial Deal.

In May 2024, CEMBUREAU, the European Cement Association, published its Net Zero Roadmap update, outlining the sector's climate ambition along the cement and concrete value chain. The roadmap revisits the sector's climate ambitions at a 2030, 2040 and 2050 horizon, in light of ongoing decarbonisation investments in the sector. It identifies specifically the ramping up of financial support for decarbonisation investments as one of the indispensable conditions to successfully realise the sector's ambition.

In this paper, we elaborate on the changes that could be brought to the EU ETS Innovation Fund to support decarbonisation investments in energy-intensive industries like cement.

State of play of financing instruments

The decarbonisation of the EU cement sector has entered its deployment phase. This requires significant investments in net zero technologies, which includes both transformative industrial technologies for decarbonisation as well as breakthrough technologies such as carbon capture. These investments are significant for any cement plant[1].

The next 10-15 years period are critical for the deployment of such net zero technologies and their scaling up. Public funding is essential to support these for the following reasons:

- As highlighted in the Draghi report on the future of European competitiveness, large parts of industrial sectors' decarbonisation investments lack a clear business case. Public support is therefore a prerequisite to de-risk these investments, enabling companies to undertake the necessary transformations.
- Public support helps bridge the significant financial gap between current practices and the adoption of breakthrough/net zero technologies, supporting a lowering of the costs of such technologies and economies of scale.
- Such cleantech solutions allow for deep CO_2 cuts at a given plant, with (in the case of CO_2-intensive sectors like cement) a significant impact on EU countries' overall emissions.
- Well-targeted public support would enable investments across value-chains within Europe, thus driving the competitiveness of the European industry.

In contrast, energy-intensive sectors benefit only from a limited number of financing instruments to support their decarbonisation investments:

- The EU ETS innovation Fund part-finances a significant number of projects in energy-intensive sectors (including cement) and is critical to support net zero investments. However, it is largely oversubscribed, and the results of recent funding calls has highlighted a risk that grants are fragmented between a high number of sectors and objectives.
- Other funding mechanisms may support some investments, but are by nature less accessible – either because they are limited in time (Recovery and Resilience Fund runs out at the end of 2026 with little or no financing foreseen for carbon capture projects), focused mainly on energy (Modernisation Fund which also has a strong regional component as it only applies to 13 lower income Member States) or are limited to specific regions within Member States only (Just Transition Fund, European Regional Development Fund, Cohesion Fund). EU Research funds (e.g. HorizonEurope) are also helpful, but focused on research and innovation rather than industrial deployment.
- State Aid support can be instrumental to part-finance large decarbonisation investments, but is not a European instrument *per se*. Furthermore, the matching clause in the Temporary State Aid Framework requires projects to cover several low-income regions, which for many net zero technology projects is a prohibitive hurdle.
- Some additional EU funding instruments may support the roll-out of net zero infrastructure (e.g. CO_2 pipelines through Connecting Europe Facility) – which is absolutely critical – but are not directed towards industrial sectors.

[1] For instance, CEMBUREAU's Net Zero roadmap includes cost estimates for carbon capture which are in a range between EUR 200 million and EUR 500 million per plant, not factoring in infrastructure costs.

Such limited and inadequately structured funds contrasts with the situation of other sectors, like the energy sector, which have enjoyed continued support through a variety of funding instruments at national and EU level. This happens at a time the EU's main competitors are launching significant schemes to support their domestic industries in the global cleantech race.

1. Turning the ETS Innovation Fund into a Cleantech Deployment fund

CEMBUREAU strongly recommends turning the existing ETS Innovation Fund into a proper Cleantech deployment fund. As a true European financing instrument, the ETS innovation fund provides pan-European support, therefore avoiding a fragmentation of the EU internal market that could occur with State Aid. Furthermore, by using directly ETS revenues, the ETS Innovation fund does not require any direct recourse to national budgets.

A first significant change to bring to the ETS Innovation Fund is to turn it into a proper 'deployment' fund. Requiring systematically an 'innovation aspect' runs counter to the deployment phase the cement sector and other energy-intensive industries are currently in. CEMBUREAU is pleased with the addition, during its 2023 revision, of Article 3 (aa) to the Delegated Regulation on the Innovation Fund, specifying that its operational objectives also cover "*(…) projects that are sufficiently mature, have a significant potential to reduce greenhouse gas emissions and are aimed at scaling up innovative technologies, processes or products to achieve their broad commercial roll-out across the EU*". However, in Article 11 of the same Delegated Regulation, which deals with the award criteria, the degree of innovation compared with state of the art is still mentioned as one of the assessment criteria.

CEMBUREAU recommendation

Together with a rebranding of the ETS innovation fund into a Cleantech Deployment fund, CEMBUREAU would therefore suggest aligning Article 11 of the Delegated Regulation with the wording in Article 3(aa) as follows:

*"(b) the degree of innovation of the proposed projects compared with the state of the art **or the potential for scaling up existing innovative technologies**"*

Secondly, the current design of the ETS innovation fund restricts its ability to support the deployment of net zero technologies and address the risks taken by 'first movers':

- The funding allocation under the ETS innovation fund is not dynamic. The grant is a fixed amount based on requirements established in early feasibility studies of projects and cannot evolve over time. However, a certain level of flexibility is required to better take into account challenges faced by projects, often subject to external costs factors beyond their control (e.g. variation of electricity or hydrogen prices, costs of CO_2 transport and storage, etc.). As such, the final grant amount should be based on the real costs estimates identified upon the completion of the Front End Engineering and Design (FEED) studies.
- Furthermore, a more realistic definition of timelines upon grant signature is needed. This is particularly relevant for such 'first of their kind' projects where complex value-chains are yet to be

defined and set up. The current 5-years time frame does not take into account such complexity and should be extended to at least 7 years, while allowing for a certain flexibility to address any delays throughout the carbon management value-chain which are beyond the control of project developers.

- The Innovation Fund is meant to support up to 60% of the relevant costs of a project, but in practice the definition of relevant costs is very narrow and is not consistent amongst the funding instruments (e.g. the definition of relevant costs under the Just Transition Fund is not the same as under the Innovation Fund).

CEMBUREAU recommendation

CEMBUREAU would suggest adapting the Delegated Regulation on the ETS innovation fund to include:

- A possibility for innovation fund grants to submit revised cost estimates following the completion of Front-End Engineering and Design (FEED) studies.
- A possibility for adjustment post-grant award and timeline to reflect significant changes in external cost factors, such as electricity, hydrogen prices, or CO2 transport and storage costs, as well as delays along the value chain, provided such changes are beyond the control of the project developers.
- The definition of 'relevant costs' should be reviewed.

2. Creating a specific cement decarbonisation fund

Furthermore, CEMBUREAU strongly believes that a specific 'cement decarbonisation fund', re-using the revenues that the EU cement sector will bring through the EU ETS, should be created. Such approach of earmarking revenues towards industrial sectors is specifically recommended in the Draghi report, which calls for sectoral approaches to recognise the specificities of different energy-intensive sectors.

While it effectively incentivises carbon reductions, the financial burden of the EU ETS on EU industrial sectors is significant and will increase in the coming years with the gradual phase-out of free allocation as part of the implementation of the EU Carbon Border Adjustment Mechanism (CBAM). Over the coming ten years until 2034, the EU cement industry is expected to pay between 80-100 Billion Euros in ETS rights. Alongside with steel, cement will likely be the most significant contributor to ETS revenues as CBAM is implemented. Frontloading these revenues in a specific cement decarbonisation fund would bring significant benefits:

- Redirecting ETS revenues back to the industries that contribute to the ETS would turbo-charge the transition in these industrial sectors.
- The reinvestment strategy would also support the EU's industrial policy objectives by fostering innovation, creating jobs, and promoting economic growth within the bloc.
- It would ensure industrial competitiveness and European leadership in the breakthrough technologies needed for the transition.
- The design of a cement specific fund is warranted as the current multi-sector schemes foresee in a comparison of projects with totally different cost structures and technology options which does not allow for a fair competitive bidding process.

- By definition, the ETS innovation fund only covers CAPEX, whilst operational costs are particularly important for companies, specifically for breakthrough technologies such as carbon capture. These operational costs could be covered by a complementary recourse to Contracts for Difference.

Crucially, the latest revision of the EU ETS Directive already foresees that the free allocation no longer given to CBAM sectors should abound to the ETS Innovation Fund and flow in priority towards these sectors[2], including through possible dedicated funding calls[3]. The idea of frontloading funding is also incorporated in the Directive[4]. The logics of frontloading ETS revenues to support the decarbonisation of the ETS sectors is therefore already well-recognised. Similarly, the Draghi report calls for a "*continuous stream of ETS and possibly CBAM revenues could be invested in EIIs*", noting that "*in particular, increased R&D and deployment funding is needed for HtA -related technologies, such as carbon capture and storage, carbon capture and use (CCS/CCU), and carbon capture technologies, to provide solutions where (full) electrification is not feasible (e.g. cement)*".

The cement decarbonisation fund could operate according to the following rules:

- 75% of the future ETS revenues generated through the auctioning towards the cement sector would be earmarked towards a 'cement decarbonisation fund'. Such fund would be ringfenced an used to launch dedicated calls for the sector.
- The cement decarbonisation fund would operate on the basis of yearly financing calls, similar to the ETS innovation fund, launched by the European Commission and abiding by similar rules – including the above-suggestions to ensure that the fund would support deployment as well as innovation.
- Such calls could include Carbon Contracts for Difference (CCFDs) to support OPEX, in addition to CAPEX-related grants. It would allow for an increased cost coverage of up to 90% of relevant costs.
- CEMBUREAU would however guard against the use of 'competitive bidding', which may lead to a race to the bottom where only certain European regions end up being supported (e.g. investments around the North Sea region only for carbon capture).

CEMBUREAU recommendation

CEMBUREAU recommends to take immediate action to launch sector-specific funding calls, and amend the EU ETS Directive article 10 as follows, to create a cement decarbonisation fund:

A minimum of 75% of the auctioning revenues generated from the industrial sectors under this Directive, which are covered by the EU Carbon Border Adjustment Mechanism, shall be earmarked to a sector-specific decarbonization projects. This energy-intensive industry decarbonisation fund should operate following the rules set out in the ETS innovation fund, and ensure that each covered sector receives a share

[2] Recital 46 of the ETS Directive : "*The free allocation no longer provided to the CBAM sectors based on this calculation (CBAM demand) is to be added to the Innovation Fund, so as to support innovation in low-carbon technologies, carbon capture and Utilisation (CCU), carbon capture, transport and geological storage (CCS), renewable energy and energy storage, in a way that contributes to mitigating climate change. In this context, special attention should be given to projects in CBAM sectors*".

[3] Updated article 10a of the ETS Directive: "*The Commission shall give special attention to projects in sectors covered by Regulation (EU) 2023/956 to support innovation in low-carbon technologies, CCU, CCS, renewable energy and energy storage, in a way that contributes to mitigating climate change with the aim of awarding, over the period from 2021 to 2030, projects in those sectors a significant share of the equivalence in financial value of the allowances referred to in paragraph 1a, fourth subparagraph, of this Article. In addition, the Commission may launch, before 2027, calls for proposals dedicated to the sectors covered by that Regulation.*"

[4] Updated article 10a of the ETS Directive: "*The Commission shall frontload Innovation Fund allowances to ensure that an adequate amount of resources is available to foster innovation, including for scaling up*".

of funding proportional to the auctioning revenues generated. It should include a cost coverage of up to 90% of relevant costs.

3. Ensuring that 100% of ETS Revenues are spent on climate

Last but not least, CEMBUREAU would like to recall that Member States are due to spend ETS revenues to support climate action. Article 10(3) of the ETS Directive sets out a wide range of objectives for which auctioning revenue can be used by Member States. Notwithstanding the obligation, in Article 10(3) ETS, for Member States to provide detailed reporting, no transparency has been provided on the exact use by each Member State for each of the objectives mentioned in that provision.

The latest Report available on the Commission's website dates back to 2017 and mentions 1.9% (only) of auctioning revenue (EUR 132 million) spent on CCS with ten Member States not even earmarking the auctioning revenue for energy and climate purposes. For its part, the Draghi report notes that whilst Member States reported that 76% of total ETS revenue from 2013 to 2022 was spent on climate, renewable energy, and enhancing energy efficiency, "o*nly a residual share of all ETS auctioning revenues goes towards decarbonisation investment in industry and the EIIs*", with most of the money being spent on electricity costs subsidies.

The reform of competition law will also be essential element in facilitating access to funding. Without touching on the fundamentals of fair competition, rules need to be simplified and clarified when it comes to offering de-risking instruments (clarify state aid rules on public guarantees), the criteria to be used for setting up Contracts for Difference at national level or the design of Projects of Common European Interest (IPCEI). A closer coordination between national state aid and European funding in terms of eligibility requirements, scope (CAPEX and OPEX) and timelines through a one-stop shop project submission are key factors for enhancing access to financing.

CEMBUREAU recommendation

CEMBUREAU would suggest to strictly monitor the implementation of article 10(3) by the EU Member States. It should further encourage Member States to support industrial decarbonisation projects through various funding mechanisms, including CCFDs.

Competition law reform, in particular state aid rules, needs to focus on facilitating the transition through simplification of rules and processes and a better alignment between European and national funding instruments.