



# Non-transparent handling of ETS revenues and potential violation of ETS Directive in the Czech Republic

Analysis

Brno, Czech Republic, 4. 11. 2021



This analysis was prepared by the Frank Bold Society (hereinafter “**FBS**”) as background material for the purposes of the ongoing update<sup>1</sup> of the EU emission trading system (hereinafter “**ETS**”). The information and recommendations should serve as guidance for the revised text of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a system for greenhouse gas emission allowance trading within the Union (hereinafter “**ETS Directive**”), so that it is well set to become an efficient tool to achieve the goals of the European Green Deal and Fit for 55 policies.

The aim of this analysis is to document the non-transparent and **potentially illegal use of ETS allowance revenues in the Czech Republic**. The analysis first introduces the relevant provisions of the ETS Directive and its transposition into national law, which differs slightly from the Directive’s framework.

The analysis uses data on the national ETS revenues use and spending, which were provided to FBS by the responsible authorities upon a public information request. The analysis points out several issues:

- ETS revenues, especially in the part dedicated to the Ministry of Industry and Trade, are **used for continuous operating support** for photovoltaic projects from the 2010s, which **does not have any incentivising effect for the energy transformation**.
- ETS revenues are only **earmarked up to CZK 8 bn. per year** (EUR 310 mil.) and the rest of the revenues are considered income to the state budget. In case ETS revenues are higher than CZK 16 bn. per year, as predicted for 2021, there is potential for **non-compliance with the ETS Directive, which requires at least 50 % of ETS revenues to be earmarked** for climate-related projects.
- The **transparency of ETS revenues use is rather low**. Information about projects supported from ETS revenues is not publicly available.

Key recommendations of the analysis are:

- ETS revenues should be **handled separately from the state budget**, so that they cannot be diluted and only retrospectively (formally) allocated to any costs eligible under Art. 10(3) of the ETS Directive.
- More **attention should be paid to the effects of the spending of ETS revenues** - especially the motivational effect of the expenditure, but also the overall contribution to the goals of the ETS system.
- **It is necessary that the revised ETS Directive introduces more specific rules on transparency of ETS revenues use**, which would enable the public as well as the European Commission to verify that all the requirements of the ETS Directive have been met.
- More information should be available about the specifics of projects supported by Member States. For this purpose, FBS also suggests **publishing Member States reports** to the European Commission regularly on how they manage ETS revenues.

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<sup>1</sup> See: [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12660-Climate-change-updating-the-EU-emissions-trading-system-ETS\\_en](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12660-Climate-change-updating-the-EU-emissions-trading-system-ETS_en).



# 1. Relevant provisions of ETS Directive and ETS Act

Under Article 10(3) of the ETS Directive, Member States have the obligation to allocate **at least 50 %** of revenues generated from the auctioning of emission allowances **to specific measures for environment protection and climate**:

*"Member States shall determine the use of revenues generated from the auctioning of allowances. At least 50 % of the revenues generated from the auctioning of allowances referred to in paragraph 2, including all revenues from the auctioning referred to in paragraph 2, points (b) and (c), or the equivalent in financial value of these revenues, should be used for one or more of the following [climate and environmental protection measures]."* (Art. 10(3) of the ETS Directive, shortened)

The Czech legislation which transposes the ETS Directive is **Act no. 383/2012 Coll.**<sup>2</sup>, on GHG emission allowance trading conditions (hereinafter "**ETS Act**"). The ETS Act requires that **50 % of ETS revenues up to CZK 8 billion** are used **every year on environmental measures** in compliance with the ETS Directive:

*"(5) Revenue from the auctioning of allowances is earmarked up to a maximum of CZK 8 billion per year or an amount equal to 100% of the revenue from the auctioning of allowances for aircraft operators and the amount pursuant to Article 10 (3) of Directive 2003/87 / EC, as amended, from the proceeds from the auctioning of allowances for operators of installations.*

*(6) Expenditures corresponding to the earmarked revenue from the auctioning of allowances are 50% realized through the chapter of the Ministry of Industry and Trade and 50% through the chapter of the Ministry and the State Environmental Fund of the Czech Republic (hereinafter the "State Environmental Fund")."* (ETS Act, Section 7, paragraphs 5 and 6)

We believe that the Czech legislation potentially violates the ETS Directive (i) due to **non-transparent handling of ETS revenues** and their use for measures **without incentivising effects** and (ii) due to the **cap of CZK 8 bn. per year** and (see analysis below). This reduces the efficiency of the ETS system and its ability to safely and responsibly transform the energy system of the Czech Republic.

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<sup>2</sup> Zákon č. 383/2012 Sb. o podmírkách obchodování s povolenkami na emise skleníkových plynů, available in Czech language: <https://www.zakonyprolidi.cz/cs/2012-383>.



## 2. Analysis of ETS revenues use

According to the ETS Act, all **ETS revenues are a part of the Czech state budget** and **50 % of this sum shall be evenly distributed between two Ministries**: the Ministry of the Environment and the Ministry of Industry and Trade. The division of funds between these two ministries is in reality rather unequal, in favour of the Ministry of Industry and Trade (see tables in chapters below).

That being said, according to our analysis, the **expenditures of Ministry of Industry and Trade** should not, in our opinion, be considered compliant with Art. 10(3) of the ETS Directive, because they **lack any incentivising effect** on climate protection and do not create additional CO<sub>2</sub> emissions reduction or savings. The **expenditures of Ministry of Environment**, on the other hand, **do not extend to 50 % of ETS revenues** in the Czech Republic and, therefore, do not by themselves ensure compliance with Art. 10(3) of the ETS Directive.

Another issue is that **the handling of these funds is highly non-transparent** and the information about how these funds are spent is not fully available to the public. The following analysis is based on information obtained by FBS via public information requests from the responsible authorities. Most of the information used is not publicly available by default.

### a) Ministry of Industry and Trade: ETS revenues use

As stated above, the Ministry of Industry receives most of the ETS revenues earmarked for climate-related projects under Art. 10(3) of the ETS Directive. The Ministry of Finance, which is in charge of the state budget, provided FBS with the information that **ETS revenues are used in the budget chapter No. 322 - Support for RES**. The table below shows that the yearly expenditures exceed the overall sum of all ETS revenues, but this chapter funds **only operational support for renewable energy sources (RES)**. We believe this is not in accordance with the meaning of the ETS Directive. Operational support does not have any motivational effect and the Czech state would have to pay for it in any case. It **does not create any additional savings and does not have a long-lasting effect**. Therefore, these expenditures should not be eligible under Art. 10(3) of the ETS Directive.

This use of ETS revenues therefore lowers the overall efficiency of the ETS system as a tool to lower greenhouse gas emissions and achieve energy transformation and **it is at least questionable whether it fulfills the criteria for state aid set by the EEAG**.<sup>3</sup>

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<sup>3</sup> Guidelines on State aid for environmental protection and energy 2014-2020.



#### *Financing of operational support for RES in Czechia*

Year	2016	2017	2018	2019	2020
Total ETS revenues (EUR mil., both Ministry of Trade and Industry and Ministry of Environment part)	126,8	206,2	590,8	638,4	749,2
Operational support for RES - total (EUR mil.)	1 614	1 709	1 731	1 682	1 712
Operational support for RES – allocated as ETS revenue expenditure (EUR mil.)	808	896	959,2	1 038,5	1 054,3

As apparent from the table above, the total operational support for RES is higher than the total ETS revenues (appx 1600 - 2 000 mil. EUR per year), out of which about one half (appx. 800 - 1 000 mil. EUR per year) is identified by the Ministry as ETS revenue expenditure. The identified ETS revenue expenditure on operational support is, however, still higher than the total ETS revenues per year. This seemingly nonsensical conclusion is a result of **ETS revenues being completely diluted in the state budget** and then retrospectively **assigned to any expense eligible** under Art. 10(3) of the ETS Directive. This approach allows the Ministry of Industry and Trade to use ETS revenues on expenditure which would have to be made regardless of the ETS system and its revenues.

#### b) Ministry of Environment: ETS revenues use

The Ministry of the Environment uses its part of ETS revenues for a grant programme called *Nová zelená úsporám* (NZÚ)<sup>4</sup> – “New Greenlight for Savings”, which is focused **on energy efficiency and renewable energy** for households and residential buildings. The NZÚ programme is considered to be of high quality and is very well targeted. According to the information provided by the responsible authorities (see table below) we assume that ETS revenues are spent fully in the NZÚ programme.

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<sup>4</sup> This programme is officially funded through the State environmental fund (Státní fond životního prostředí – SFŽP) and the Ministry of Environment allocates ETS revenues to this fund.



#### ***Financing of NZÚ program for energy efficiency and renewables in households in Czechia***

<b>Year</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Total ETS revenues (EUR mil., both Ministry of Trade and Industry and Ministry of Environment part)	126,8	206,2	590,8	638,4	749,2
Ministry of Environment - real expenses on NZÚ program (EUR mil.)	46	65	71	74,6	103
Final NZÚ expenditure (% of total ETS revenues)	36 %	31 %	12 %	11,6 %	13,7 %

From comparison of ETS revenues allocated to both ministries, it is apparent that the **Ministry of Environment's portion is significantly smaller**, even though the Czech ETS Act requires that the ministries get an equal portion of the revenues. Furthermore, based on FBS's research, the money not spent by the Ministry of the Environment (years 2018 and 2019) is then reallocated to the **Ministry of Industry and Trade** and there used for operational support, which is higher than the total amount of ETS revenues. However, we cannot say that for sure, because we suspect that the amount of ETS revenues not spent by the Ministry of Environment **goes back to the state budget** and is then redistributed **without any purpose** (e.g., for environmental measures).

FBS has submitted requests for information to both ministries on **how much of the ETS revenues have been used for measures in compliance with ETS Directive**. FBS was assured by the ministries that everything is done in accordance with the Czech ETS Act and the ETS Directive. However, the information provided shows that while the formal requirements of the ETS Directive might have been fulfilled, **the chosen use of ETS revenues in the Czech Republic does not effectively contribute to achieving the goals of the ETS system**.

For the purpose of the revision of the ETS Directive, FBS welcomes that **all ETS revenues (instead of only 50 %) shall be earmarked** for climate projects. Furthermore, the analysis suggests that there is vast potential for improvement regarding the **transparency of ETS revenues use** and public access to information. Finally, it seems important that the ETS Directive explicitly states that the use of ETS revenues should have **proven positive effects on the decrease of CO2 emissions**, including the motivational effect of the funds.



### 3. Cap on ETS revenues potentially in breach of the ETS Directive

The **Czech ETS Act introduces a cap on ETS revenues** which are to be spent on “climate-related” projects, under Art. 10(3) of the ETS Directive. The cap was originally set to CZK 12 bn. (EUR 475 mil.) and **effective from 1. 1. 2021 it was lowered to CZK 8 bn.** (EUR 316 mil.). At the same time, the ETS Directive requires that at least 50 % of ETS revenues are used for climate-related projects under Art. 10(3) of the ETS Directive. This means that even if ETS revenues surpass CZK 16 bn. (EUR 633 mil.) per year, still only CZK 8 bn. (i. e. less than 50 % of the revenues) remain earmarked for climate-related projects.

This constitutes a **potential violation of the ETS Directive** from 2021 on. In 2020 the amount of revenues generated from the auctioning of allowances was CZK 18,9 bn. and in 2021 the amount **is expected to be even higher** because of the higher price of emission allowances.

For the purposes of the revision of the ETS Directive, FBS suggests that **ETS revenues should be formally separated from the state budget**, so that any non-compliance with the ETS Directive can be more easily identified and prevented. Also the analysis suggests that **higher levels of transparency** and Member States reporting obligations towards the European Commission would help prevent situations such as described above.



## 4. Conclusion

Based on the analysis presented above:

- FBS welcomes the revision draft of the ETS Directive<sup>5</sup>, which suggests that **100 % of ETS revenues should be used for environmental measures**. We believe that this measure could be more efficient if Member States were to provide information more transparently and publicly on how they spend these revenues.
- FBS suggests that **it is necessary the revised ETS Directive introduces more specific rules on transparency of ETS revenues use**, which would enable the public as well as the European Commission to verify that all the requirements of the ETS Directive have been met.
- More information should be available about the specifics of projects supported by Member States. For this purpose, FBS also suggests **Member States publishing reports** regularly to the European Commission on how they manage ETS revenues.
- ETS revenues should be **handled separately from the state budget**, so that they cannot be diluted and only retrospectively (formally) allocated to any costs eligible under Art. 10(3) of the ETS Directive.
- **More attention should be paid to the effects of the spending of ETS revenues** – especially the motivational effect of the expenditure, but also the overall contribution to the goals of the ETS system. The use of ETS revenues should be strictly assessed in the light of EEAG and made compliant with its requirements for state aid, including its incentivising effect.

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<sup>5</sup> Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757, [COM\(2021\) 551 final](#).