

Modernisation Fund in Czechia:

Are we using our funds effectively? Is subsidising the industrial and energy sectors the right way to decarbonise?



The Modernisation fund is a programme from the European Union for 2021-2030 that aims to provide financial support to **13 low-income Member States in modernising their energy systems and improving energy efficiency.**

The fund is financed by revenues from the auctioning of emission allowances. The **polluters' emission fees are therefore invested in decarbonisation.**

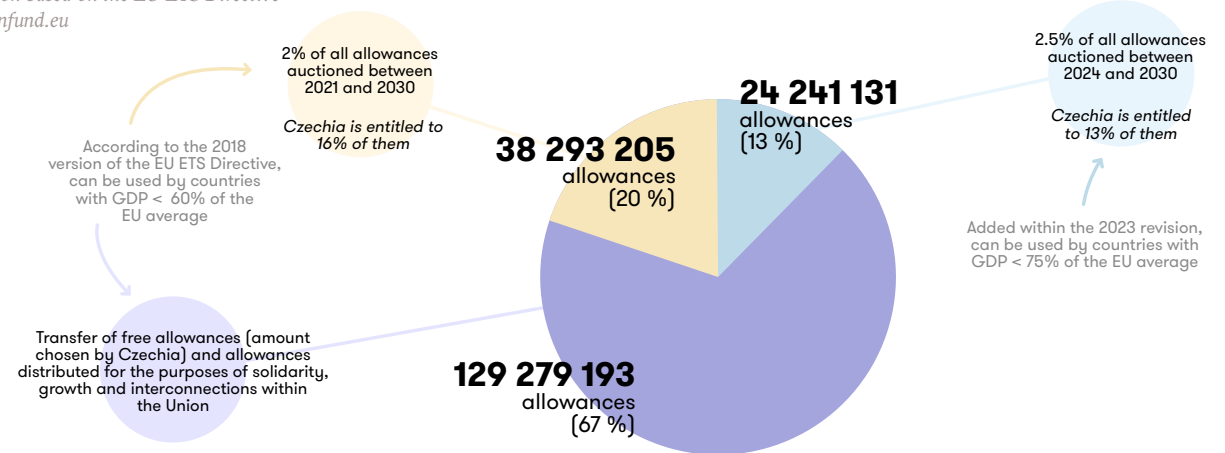
The total size of the fund is not fixed but depends on the price of allowances.

In Czechia, the money is disbursed through various **programmes**, such as RES+ for renewable energy sources and HEAT for the heating sector, with individual **calls for proposals** issued on an ongoing basis.

The **European Investment Bank (EIB)** controls and approves the funds' use. At the national level, the Ministry of the Environment (MoE) is tasked with the decision-making process regarding finance allocation, adhering to the European Commission's criteria. The State Environmental fund (SEF) manages the fund.

Czech Modernisation fund sources

Source: Own compilation based on the EU ETS Directive and www.modernisationfund.eu

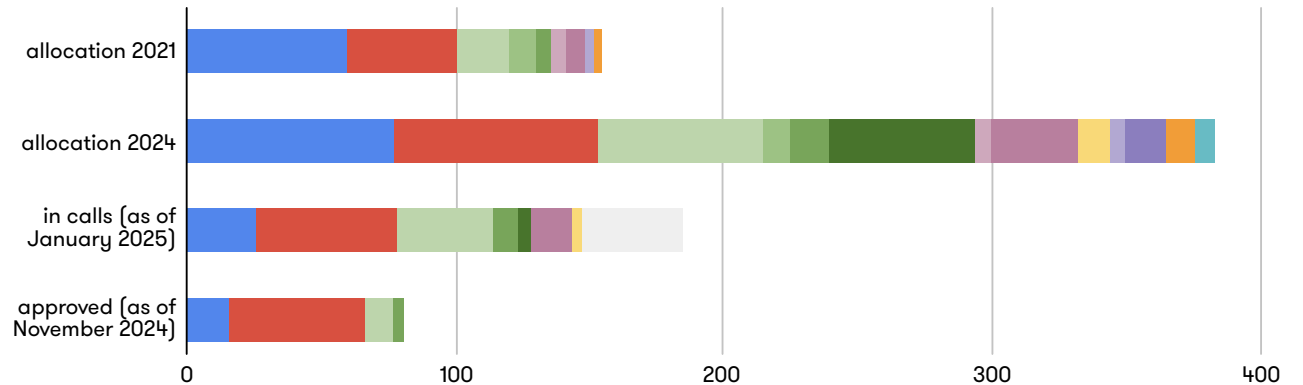
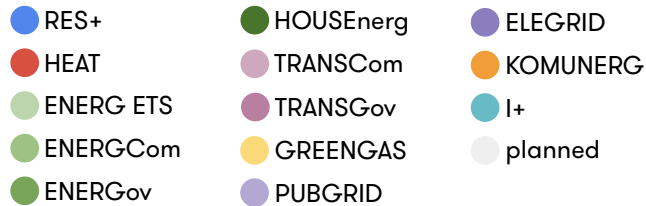


Conditions for the utilisation of the Modernisation fund

- The selection of projects to be supported by the Modernisation fund in Czechia is significantly influenced by **the EU ETS Directive**. The fund was established by it in 2018 and revised in 2023.
- The Directive stipulates the allocation of allowances to the fund and the designated use of the available finance by Member States. **Heat pumps** were for instance only included in the priority projects category (1) following the Directive's revision. Other priority investments include renewable energy generation, building renovation, support for low-income households, and just transition.
- The revised Directive also terminates the option to use **free allowances for energy sector modernisation by the end of 2024**. However, Czechia has transferred all its free allowances available until 2030 to the Modernisation fund, meaning this change will not affect it.
- Consequently, the Czech programme document was revised in 2024, setting new priorities for support in **energy storage, hydrogen use, electricity grid modernisation, community energy and innovation projects**.

¹ Majority of the money must be used to support priority investments. I.e. at least 80% of the revenue from the original quantity of allowances (2% and transfer), and 90 % of the quantity added after the revision (2.5%).

Modernisation fund programmes



Source: Own analysis based on SEF data and the Report on the State of Implementation of the Modernisation fund in the Czech Republic

CZK bn

Decarbonisation sources and demands

- According to the June 2024 estimate by the Ministry of the Environment and the State Environmental fund, **CZK 380 billion** should be available in the Modernisation fund. This figure may seem significant, especially compared to the original 2021 estimate, which predicted 'only' CZK 154 billion due to the lower price of allowances and their reduced amount in the fund.
- However, based on SEEPIA analysis, the National Energy and Climate Plan foresees a **need to invest CZK 2.8 trillion in decarbonisation between 2023 and 2030**; of this amount, **CZK 1.3 trillion should be provided from public sources**. Such a figure is still 3.5 times higher than the assets of the Modernisation fund.
- Less than **half the estimated budget has already been allocated to individual calls**, and we are still far from halfway through our decarbonisation efforts.
- Therefore, it is essential to consider whether the funding from the Modernisation fund is being used in **the most effective way**.

Subsidy assessment criteria

- The process of setting up subsidies is not without its challenges. For subsidies to be effective, they must align with beneficiaries' needs, and beneficiaries may be incentivised to overestimate these needs. How should we approach this matter in considering the projects the fund should support?
 1. **Efficiency** is about directing financial resources towards activities with the most significant impact, such as achieving the highest possible emissions savings or installed capacity per Czech crown. In its mandatory annual reports to the EIB, Czechia provides estimates of the MWh of energy saved, the MW of newly installed RES capacity, the tonnes of CO₂ emissions saved, and the price for each such tonne. However, the intricacies of the data remain opaque, including the specific programmes to which they pertain and the status of their implementation. Additionally, a link to the fund's national decarbonisation targets is conspicuously absent from the programme and call documents, hindering the assessment of cost-effectiveness and the achievement of targeted savings.
 2. The **return** on key decarbonisation investments varies. The ROI in flat-plate photovoltaics, wind turbines, or home insulation is expected to be around ten years. In comparison, it can take up to 20 years or more for other investments, such as grid reinforcement, hydrogen infrastructure, district heating, or less common technologies, such as large heat pumps. While subsidies can be helpful in social policy, public services, or systemic measures, they are not appropriate for repayable investments.

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RES+ in focus

→ Over one half of the entire RES+ programme, i.e. CZK 8 billion, was received by 8 largest beneficiaries. This group includes large energy companies like ČEZ, Sokolovská uhelná or Sev.en.

How did this happen? The fund's rules try to meet this challenge halfway.

- Firstly, the Act on conditions for greenhouse gas emission allowance trading No. 383/2012 Coll. states that free allowances under Article 10c of the Directive are to be used as a priority for **projects of electricity generation facility operators**. The rules of the RES+ call then state that „projects of electricity producers under Article 10c of the Directive will be selected for funding as a priority.“ (It should be noted that this condition was removed from the updated programme rules in December 2024.)
- Secondly, the **law favours projects in regions affected by coal mining decline**. In practice, projects located in coal regions were awarded an extra 10 points.
- Large companies covered by the EU ETS and active in the coal regions then have the capacity to implement large PV projects and receive support from the fund.

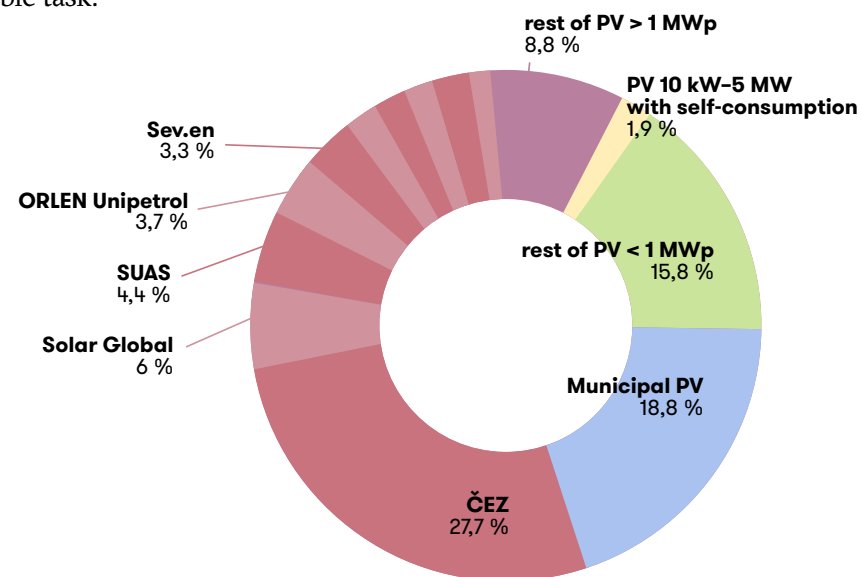
Subsidy assessment criteria

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- 3. Additionality** refers to whether the investment would have been made in the absence of public support. The mounting pressure to transition away from coal is compelling energy companies to explore alternative solutions, irrespective of subsidies. Furthermore, the cost of a project without subsidies can frequently be lower.
- 4. Risk Assessment:** Would the project be constructed without subsidies? It is possible that ROI does not constitute the sole impediment to investment. Indeed, there are projects with a reduced ROI but elevated uncertainty, such as those pertaining to electricity prices, which act as a deterrent to investment by companies and banks providing loans for refinancing. Financial instruments such as guaranteed or low-interest loans are preferable to a 30% subsidy for projects deemed risky but repayable, including photovoltaics.
- 5. Beneficiaries:** The government's utilisation of subsidies has been identified as a key factor in reducing the ROI (be it 5 or 20 years), thereby providing direct support to beneficiaries, including companies with substantial turnover and extraordinary profits from the energy crisis, who possess the necessary equity capital for investment. The Modernisation fund, as stated in its mission statement, prioritises the promotion of a just transition, which encompasses, in addition to technological change, the mitigation of inequalities and the decentralisation of power. It is imperative to consider which firms the government increases profits for, as this enables the government to set more favourable conditions for SMEs or caps on subsidy support.
- 6. Systematicity:** Notwithstanding the returns, there are instances where it is necessary to provide support for large strategic and systemic investments through subsidies. Such investments may include railways, distribution networks, large heat pumps, hydrogen ironworks, the rescue of central heating systems, and so forth. The question that arises is whether these investments should include the construction of photovoltaics, which is a less complex yet more divisible task.²

Approved proposals in calls within the RES+ programme

Source: own compilation based on SEF data



Subsidies vs. financial instruments

- Financial instruments, such as guarantees, soft loans, or capital inputs, serve the same purpose as subsidies regarding financial support but **are repayable, unlike non-refundable subsidies**.
- The primary benefit of financial instruments is that the funds can be reused. Initially, they are employed to provide stability and certainty, and after a certain period, they return back to the state treasury.
- **All funding distributed by the Modernisation fund (as of January 2024) has been allocated as subsidies.** In March 2024, a first call containing a financial instrument was launched: **interest-free loans to banking institutions**, which will then provide soft loans to building renovation projects supported by the „Oprav dům po babičce“ call. The second financial instrument is a fund to provide soft loans for energy efficiency improvements and energy reduction in the business sector, published in January 2025.
- So far, **financial instruments account for less than 3%** of the total amount in the fund's calls, including planned ones.

Financial instruments overview

Loans:

Loans with favourable interest rates

- **Intermediated loans:** Loans provided by the EIB through intermediaries, such as the National Development Bank (NDB) which provide loans to beneficiaries;
- **Subordinated loan:** In the event of borrower default, the debt will be classified as other debts in terms of repayment priority. This means that the creditor will be exposed to a higher risk.

Direct participation: Acquiring a stake in the project through common or preferred stock, warrants, etc.

Guarantees:

to cover the risk of default

- **Local currency loan guarantees:** Ensures repayment of specific projects in local currency;
- **Portfolio Asset Guarantee:** A risk-sharing instrument where a guarantor (e.g., NDB) provides coverage for a portion of the portfolio losses;
- **Asset securitisation:** Reducing investment risk by pooling financial assets into securities.

Quasi-capital:

A combination of loans and capital

- **Contingent:** Terms and conditions are conditional on meeting the objectives of the project;
- **Participating:** The lender receives extra revenues if the project is profitable;
- **Convertible:** The lender can convert the loan into equity.

Sources

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