

**FOR A FUTURE SUSTAINABLE,
COMPETITIVE AND GREENER
EU BUDGET**

**INTEGRATING THE CLIMATE
CHANGE OBJECTIVES OF THE EU**

FINAL REPORT OF A CEPS TASK FORCE

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This report is based on discussions in the CEPS Task Force on “A Green Budget for a Sustainable Future: Adapting the EU Budget to Climate Change”. The Task Force met several times between March and October 2009.

The members of the Task Force engaged in extensive debates in the course of several meetings and submitted comments on earlier drafts of this report. It reflects the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position agreed among all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members, the Chairman or the rapporteurs belong.

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EXECUTIVE SUMMARY

The discussions on the future of the EU budget are reaching an important turning point, with the European Commission supposed to publish its long-awaited, budget review document. Unfortunately, in recent years and amidst the review process, the number and kinds of challenges facing the EU have changed. Most notably, the world has been shaken by two crises – the global, financial meltdown and a worldwide food crisis – in addition to the prospects of catastrophic climate change. The reform of the EU budget has to take stock of these pressing and to large extent unprecedented global concerns. Indeed, the public consultation launched by the European Commission on the review of the EU budget placed climate change among the top priorities.

A common characteristic of all three challenges is that they call for serious policy action, substantial public resources and are linked to a significant degree of uncertainty. While the impact of the financial crisis may ebb away, efforts to manage global food requirements, mitigate the adverse effects of climate change and foster adaptation entail very complex issues and possibilities. Opinions on what actions to take diverge as wildly as do the forecasts for the long-term impacts of climate change. We have a broad sense of what is coming, but how to approach it remains unclear. Future food and climate risks give rise to complicated scenarios in a number of areas, ranging from food, trade and energy policy, to external aid and security.

For the budget review, this has introduced a whole new set of factors to consider. No longer can the discussion about the future of the budget concentrate on reforming the common agricultural policy (CAP) or targeting R&D and the cohesion policy more towards growth. The Lisbon agenda, until recently the central project of the EU, is today just one of several critical matters with which it must deal.

This report considers the impacts of climate change and the extent to which the EU budget can effectively assist in addressing them. Based on the analysis, the report recommends the following fundamental reforms to the EU budget, which are necessary for the EU to achieve its objectives on climate change, along with helping it to lead the global effort to curb greenhouse gas (GHG) emissions and adapt to the changes:

- Increase the support to R&D on energy and climate change, and more specifically expand the financial support for the Strategic Energy Technology (SET) Plan and the demonstration of new technology, in which the risks and long-term maturity of the projects precludes the possibility of exclusively private participation.
- Boost the support for trans-European and pan-European energy and transport links, with an emphasis on interconnectors and rail. The motorway tax Eurovignette should be introduced across the EU and be partially used to fund green transport links.
- Promote, through the guidance function of EU funding, the adoption of the best energy-efficiency practices, and especially
 - reinforce support for energy efficiency and renewable energy;
 - introduce best-practice conditionalities across all funding areas;
 - support the development of low carbon cities and regions in the EU to test and promote new technologies on a large scale, and take advantage of the need to renew energy grids in new member states; and
 - introduce energy-efficiency conditionalities and best practices in EU procurement rules.
- Reduce the share of the CAP in the EU budget by finding new financial mechanisms to introduce national co-financing, taking into account the national fiscal positions.
- Focus research on emission reductions and improved land management in agriculture, particularly possibilities for increasing the carbon storage capacities of land.
- Increase the EU's interventions on environmental matters, taking into consideration the need to protect ecosystems and promote resource efficiency.

- Concentrate more resources on waste management to reduce methane emissions more quickly.
- Better coordinate external action on climate change, centralising the effort and preferably funding of the EU's obligations through the external action budget.
- Extend the reach of the EU budget by expanding the use of financial mechanisms through the financial sector, most notably the European Investment Bank (EIB). In addition, a fundamental reform should be envisaged by which the European Commission is allowed to raise capital by issuing EU bonds for large projects of EU-wide interest.

In arriving at these conclusions, the report analyses the major difficulties ahead and looks at methods through which the EU budget, given its limitations, can most effectively assist the EU in reaching its emissions targets and meeting its adaptation needs. It takes into consideration the objectives of the EU, the principles that should govern its interventions and the limitations of the budget.

The EU budget was out of line with the EU's objectives and concerns well before the crises struck and climate change became a central priority. Yet the budget has the potential to play an important role in a number of areas, notably climate change. Aligning the EU budget towards transforming the energy sector, reducing other emissions, helping regions implement mitigation and adaptation policies, supporting R&D and creating green jobs is not only justifiable, it is also in line with the need to develop a sustainable, knowledge economy, i.e. the Lisbon and Gothenburg agendas.

The report shows that the EU budget has to integrate climate considerations across the entire spectrum of its actions, given the highly varied and horizontal implications of climate change. The EU budget needs to be climate 'proofed', i.e. compatible with the mitigation and adaptation requirements of the EU.

The four functions for which it is the most appropriate instrument to promote EU objectives in this area are listed below.

- a. **Solidarity.** The EU budget is the best existing, financial solidarity instrument among the EU member states. The potential for climate change mitigation and the necessity of adaptation may be highest in countries with little budgetary resources. Thus, support through the EU budget may be an effective way to ensure important investments

are made where they would not have otherwise occurred. Where large transboundary benefits are expected, the EU budget can act as a mechanism to ensure an appropriate level of burden sharing among beneficiaries.

- b. Guidance.** The EU budget can be used as an incentive for attracting investment in specific areas through its leverage instruments. Where important EU priorities are unlikely to be funded locally, because the EU-wide benefits are greater than the local ones, the EU budget is a powerful tool to draw in the necessary investments. Trans-European energy and rail infrastructure, R&D or environmental actions with cross-border effects are such cases. Conditionalities for funds offered for poorer regions can be highly influential on national and regional development strategies.
- c. Loan guarantees.** The use of some of the EU budget to increase the loan guarantee funds of the EIB would represent another very effective instrument in the release of loans to the private sector for more risky venture-capital investments or large, complex, longer-term projects. Loan guarantees are already used for example by the European Investment Fund of the EIB. It has been recorded that the participation of the EIB in projects has helped to attract venture capital from other private financial institutions. The scope to expand into such instruments is large, but it will require further re-evaluation of the role of the EU budget – which is still very much based on a grant/subsidy mentality.
- d. Coordinated external action.** Generally, the use of centrally coordinated action for foreign assistance is theoretically considered more efficient than each member state running separate programmes. Funding for development actions abroad, which should be compatible with adaptation and mitigation objectives, could be better accomplished by a common EU instrument. A single voice from the EU within international institutions – backed by a single powerful instrument – would strengthen the negotiating position of the EU and help the EU to promote its visions of climate action and development. It would also increase the EU's visibility and make it more accountable. National programmes, even using common criteria, face higher risks of overlapping and running into coordination problems.

The financial limitations of the EU's budget restrict the EU's actions, and hence its role is greatly affected by national strategies. Coherence with programmes and policies in the recipient countries and regions is paramount.

One of the most important objectives of the EU is to implement its energy and climate change package and manage to achieve its objective to reduce emissions by 20% in 2020 (up to 30% in the case of similar efforts by other industrialised countries) and by 60-80% or more in 2050. The EU budget could play a crucial role through well-devised interventions.

First, the EU budget could facilitate the realisation of an integrated energy grid by supporting the completion of energy interconnections among member states through the budget for trans-European networks (TENs). This is vital for energy security, energy efficiency and the completion of a single market in energy. Given the objective of developing a large-scale, renewable energy capacity, it is also important that HVDC (high-voltage direct current) connections link member states. These allow long-distance energy transport with low levels of energy loss, and they can help counteract the fluctuations of energy intensity arising from renewable energy sources while minimising the need for backup energy production. Work in this area will also enable linkage across the EU as a whole to the best renewable energy locations – sun from the south, and wind and hydro from the north.

Another key role for the EU is in R&D. Through its budget and the SET Plan, the EU could speed up the development of new technologies. EU action can pool the knowledge of the best researchers and leading industries with joint programmes. In addition to providing funds for research, the EU budget could cater for the need to support the large-scale testing and deployment of new technologies, where the upfront investment is too high given the risk involved for private companies to undertake this in isolation. Care has to be taken to ensure adherence to the principles of additionality and proportionality. The EU should be adding to and not substituting national public or private funding, and catalysing these resources to enhance their impact. The report indicates that there are structural problems within the EU that limit R&D investments from the private sector, and that member states should investigate how to introduce the necessary positive incentives.

The cohesion policy could also play an important role. Especially in the new member states, the energy grid is out of date and requires upgrading. Through its cohesion and structural funds, the cohesion policy could promote the creation of low carbon zones and co-finance new interconnectors and smart grid systems with the involvement of national authorities and energy companies. The present assistance for green energy still consists of single projects without a coherent strategy. The EU could help build highly effective and coordinated programmes.

The creation of low carbon zones along with the transformation of energy and transport systems in poorer countries and regions will foster the creation of green jobs, as well as the development of a modern knowledge economy. It is an opportunity not to be missed. There is a need, however, to improve the strategic planning and implementation capacity in member states. Many are ill prepared to handle such complex multiannual and highly integrated developments. The level of state participation and the in-depth collaboration needed among state departments, regional bodies, the research community, private business and wider civil society is for many administrations unprecedented.

EU funds could additionally support actions to reduce methane emissions, especially by tackling those from waste and other sources from urban areas. Methane is a potent GHG and a number of known sources can be easily neutralised. This could be done in Objective 1 regions, for example, through the structural funds for waste management programmes.

Stronger environmental action is essential and the EU should have a larger environmental budget to intervene. Many mitigation and adaptation programmes reflect EU priorities and their benefits or impacts are cross-border in nature. The EU budget should be able to function as a mechanism to finance projects that have a European added value beyond the territory in which they are implemented. Examples are listed for mitigation and adaptation, as well as environmental catastrophes, such as wildfires and flooding. It is crucial to build a better pan-European response capability.

In the area of transport, the report highlights the necessity of speeding up the completion of the TEN rail and waterways systems, particularly for cargo, which demand greater budgetary intervention. Furthermore, to foster the switch to greener transport systems, it is recommended that member states introduce the Eurovignette to their motorway networks, using part of the revenues to develop greener transport systems.

The agricultural sector will likewise have to play a role, although the capacity to reduce emissions in the EU is limited. Still, through better farming practices and novel land-management, important reductions in emissions may be achieved – even contributing to a considerable level of carbon capture. In some cases, it is possible to contemplate the sector's integration into the Emissions Trading System (ETS) if it were able to sell emission credits.

Climate change will in any case hit the agricultural sector hard, especially in areas affected by drought and flooding. The present policy needs to change the support system and channel funds to real actions better linked to the actual costs of practices. The role of the insurance sector has to be reassessed. Private insurance schemes could cover more variability, while public funding could offer guarantees for extreme cases that private insurers would not cover.

On external action, the EU is underfunded in view of the increasing external challenges. For reasons of coherence and efficiency, it is recommended that climate change obligations be dealt with through a central budget. Initially, however, this element could be financed through a separate budget, as was the case for the European Development Fund in the past – especially if increases in expenditure are needed before the new Financial Perspectives, which is likely. It could later be incorporated into the EU budget or not. The external budget for climate actions could be funded by ETS revenues.

The EU budget is financially a very limited instrument and it will likely remain strained. That is why the report calls for reinforcing the leverage principle of the budget. It should not be funding any policy entirely, which is the case of the CAP. The report calls for the introduction of co-financing for agricultural support, preferably with a solidarity mechanism, whereby rates would vary depending on the fiscal capacity of member states.

Even with a smaller budget for agriculture, the limitations imposed on the budget severely constrain the EU's ability to act decisively in large projects of EU-wide interest. The funding levels for TENs and research are too low to contribute significantly to the finalisation of TENs in transport and energy or to finance the large-scale demonstration and testing of technologies.

The green stimulus packages will eventually end and some mechanisms should be in place to maintain the momentum. It is for this purpose that the EU has to explore further the expansion of the budget into financial solutions, such as loan guarantees for funds from the EIB or the European Bank for Reconstruction and Development, or even the possibility of allowing the EU to launch bonds to finance large projects of EU-wide interest.

The report explains the role the EU budget and lists the ways it can contribute to achieving the climate objectives of the EU. Along with helping to accomplish emission reductions, the actions presented would greatly foster the creation of green jobs and the development of a knowledge economy. The EU would benefit from these actions, additionally enabling it to keep a leading edge in green technology, which in the future will be in high demand globally.

A lukewarm integration of climate objectives in the budget and the continuation of a rather uninspiring set of budgetary actions will only damage the image of the EU institutions and send the wrong signal to EU citizens and international partners. It is time for a budget that confronts the multiple challenges ahead in a coherent fashion. Anything less will further erode the EU's standing and legitimacy, and ultimately its capacity to lead on the climate agenda in the EU and beyond.