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AN EU BUDGET FOR CLIMATE ACTION: ACCELERATING THE LOW-CARBON TRANSITION IN CENTRAL EASTERN EUROPE

ALEXANDER REITZENSTEIN, SABRINA SCHULZ,
PIETER DE POUS & ADA AMON

This paper aims to inform the negotiations between Member States, the European Parliament and the Commission on the post-2020 Multiannual Financial Framework (MFF).[1] The specific focus of our analysis and recommendations is on how the MFF can foster climate action and accelerate the low-carbon transition in Central Eastern Europe (CEE). We suggest the following CEE priorities for the MFF post-2020:

> Increase the share of climate-related spending to 40% of the next MFF.

> End all support of and funding for high-carbon infrastructure, thus avoiding detrimental impacts across the whole budget.

> Ensure effectiveness of climate-related spending and facilitate direct access to funding for regions and municipalities.

> Within the next MFF, establish dedicated programmes, strong funding instruments and a revenue base for climate action and just transition.

> Balance interests of net payers and recipients, tailor programmes to the needs of high-carbon transition regions and leverage the potential of regional co-benefits.

More generally, E3G also advocates to increase the funding reserved for climate-related R&D; that EU institutions support national and regional resilience planning and that the Cohesion Fund is used to up-skill people for the low-carbon transition.[2]

[1] Elements of this briefing are inspired by a roundtable discussion on EU budget priorities for the CEE region, hosted by E3G in the European Parliament on 8 March 2018, bringing together stakeholders from the European Commission, the European Parliament, civil society organisations, business and academia. A recording of the discussions can be found at **http://greenmediabox.eu/en/ct/128-What-EU-budget-to-dial-up-climate-ambition-in-Central-Eastern-Europe**

[2] For E3G's broader MFF recommendations, see: E3G (2018), **Climate change and the EU budget – What to make of the new proposals?**

Context: The Commission's proposals for the post-2020 MFF

On 2 May, the European Commission published its proposal for the post-2020 MFF,[3] outlining headline budget priorities.[4] Detailed proposals for sectors will follow in the coming weeks. The Commission's proposals take several important first steps towards fostering climate action and accelerating the low-carbon transition in Central Eastern Europe[5]:

> It proposes to increase the share of climate mainstreaming from the current 20% to 25%, falling short of the 40% called for by President Macron or the 30% supported by the European Parliament.

> It also turns to environmental instruments to increase the EU's own resources by allocating 20% of ETS revenues to the EU budget and introducing a tax on plastics.

> However, it falls short of announcing a phase out of all fossil fuel funding thereby increasing the risk of EU funds being wasted on infrastructure that will become stranded as the EU decarbonises.

> Finally, the budget proposals were accompanied by a new control mechanism which allows the Commission to withhold the release of EU funds if it finds that a Member State is unable to meet minimum standards in the rule of law.

For the EU's budget to become an instrument that ensures delivery on the EU's Paris commitments (both current and new commitments following the next stocktaking exercise) the Council and the European Parliament will need to push for significant improvements during the forthcoming negotiations.[6] The Commission aims to finalise the negotiations before the European parliamentary elections in May 2019.

[3] European Commission (2018), **EU Budget for the Future**

[4] Source of infographic: European Commission (2018), **A Modern EU Budget for a Union that Protects, Empowers, and Defends**

[5] European Commission (2018): **Sustainability, Environment Protection and Fight against Climate Change**

[6] See E3G (2018), **Climate change and the EU budget – What to make of the new proposals?**

Context: Importance of the MFF for climate action in Central Eastern Europe

The current MFF (2014-2020) allowed for significant progress regarding overall and regional low-carbon investment. However, more needs to be done to align spending with European and global climate policies, most notably the Paris Agreement, in a complex political environment. The EU has, during the current budget period, significantly increased its climate funding through both the European Structural and Investment Funds (ESIFs) and cohesion policy. Investments in energy efficiency through the European Regional Development Fund (ERDF) and the Cohesion Fund (CF) were increased from €6 billion in 2007-2013 to €18 billion in 2014-2020.[7] Nevertheless, the EU will likely miss its goal to spend at least 20% of the overall EU budget on climate-related activities, as a report by the European Court of Auditors found.[8] Especially in the European Social Fund, and in the areas of agriculture, rural development and fisheries, there has been no sufficient shift towards climate action, and there is little indication for significantly higher ambition, for example in the new Common Agricultural Policy (CAP) proposals.

In addition, the next EU budget is widely expected to address several big challenges such as persisting regional disparities, wealth and income inequality, unemployment as well as asylum and migration policy, which will likely dominate the negotiations for the MFF post-2020. Brexit is expected to reduce contributions to the EU budget by approximately €12 billion and, with only a few Member States having shown willingness to cover the gap, could be addressed through spending cuts.[9] Put simply, competition will be stronger for a potentially reduced budget. A smaller EU budget could also have implications for the eligibility of Western European regions for cohesion funds.[10] For these reasons, it will be crucial to insist that spending on climate and Paris-compatible projects, coupled with effective governance and monitoring mechanisms, is a top priority.[11]

The EU budget is a key tool to raise climate ambition in Central Eastern Europe and reduce regional disparities. There is a growing East-West divide when it comes to climate ambition: in CEE, any political momentum towards a low-carbon transition in coal and other high-carbon regions is weakly developed; major coal power plants receive free allocations within the EU ETS; effort-sharing targets are too low due to generous business-as-usual scenarios; capital costs for renewables are much higher due to risk perceptions of investors[12]; and nuclear power is frequently favoured over electricity from renewable energy sources (RES). Furthermore, low investment levels in

[7] European Commission (2017), **EU cohesion policy support for energy efficiency**

[8] European Court of Auditors (2016), **Spending at least one euro in every five from the EU budget on climate action**

[9] Herzenhorn in Politico (2018), **Eastern countries commit to bigger EU budget after Brexit**

[10] Eder in Politico (2018), **Commission gets glimpse of post-Brexit EU budget horrors**

[11] For E3G asks, see also: Gaventa (2018), **Five steps for a climate-friendly EU budget**

[12] Agora Energiewende (2018), **Reducing the cost of financing renewables in Europe**

low-carbon technologies result in a higher prevalence of energy poverty, lower air quality, and a lower adaptation capacity as well as a significant protection gap with regards to climate risks.[13] In addition, regional disparities and inequality are likely to increase once the pressure on the coal sector becomes too big to keep it alive artificially. For these reasons, the EU budget is essential to accelerate climate action in CEE, for example to improve energy efficiency in buildings, to compensate for public investment gaps and to leverage private financing. While Poland and the Czech Republic are already the top net recipients of funding for energy efficiency (ERDF and CF) in the current EU budget[14], more needs to be done to lower regional disparities.

However, a larger EU climate budget needs to be accompanied by strong control measures to ensure effectiveness and efficiency of spending. Some CEE governments have come under criticism from journalists and watchdogs for circumventing earmarking rules and channelling money to political allies despite the new ex-ante conditionalities of the current MFF.[15] Given a strong focus on the high-carbon economy and energy security in CEE national policies, well-designed EU support schemes in CEE are key to meeting EU-wide climate and energy targets and ensuring sustainable economic development in current high-carbon transition regions.

[13] For more information, see E3G's paper: Campillos and Cook (2018), **Climate Risk and the EU Budget**

[14] European Commission (2017), **EU cohesion policy support for energy efficiency**

[15] For example: Transparency International Hungary (2015), **Corruption Risks of EU funds in Hungary** and Puhl in Spiegel Online (2017), **A Whiff of Corruption in Orban's Hungary**

Key post-2020 MFF recommendations to raise climate ambition in Central Eastern Europe

Increase amount and share of climate spending in the EU budget to at least 40%. The current target to spend at least 20% of the budget on climate-related activities, although not achieved, has been an important instrument to step up spending levels. French President Emmanuel Macron's suggestion to increase spending for an ecological transition to 40%[16], and the European Parliament's proposed 30% target for climate-related activities[17], are welcome voices to scale up this commitment which should now be supported by heads of state, governments and other key stakeholders. The Commission's proposal to spend 25% on climate across all programmes can also be regarded as a promising start to the debate on how to raise the additional €170 billion per year necessary to meet the 2030 climate and energy targets.[18] Higher earmarking targets should be set for relevant programmes such as the ESIFs, the Connecting Europe Facility, and Horizon 2020. Stricter earmarking matters for CEE in particular as many high-carbon and coal-mining areas are located in the region and require more and better targeted funds to help with a low-carbon transition.

Ensure that detrimental impacts in the remaining parts of the budget are avoided. All other funding within the EU budget should be harmonised with the Paris Agreement, including through an **end of all EU funding to high-carbon infrastructure**.[19] Climate should be mainstreamed across all areas of EU investment, and the EU budget must be linked to the Energy Union governance framework and the 2030 energy and climate policy framework to support the future implementation of the National Energy and Climate Plans (NECPs). This aspect is of utmost importance in high-carbon CEE regions to avoid infrastructure lock-in effects and ensure that GHG mitigation targets are met across Europe.

Ensure effectiveness of climate-related spending. The effectiveness of investments is a key concern of EU climate and cohesion policy[20] and comes on top of broader concerns about the correct and lawful use of funding in several CEE countries, with reports of a systematic misuse of EU funds in, for example, Hungary.[21] The Commission should ensure regular and effective monitoring and evaluation to guarantee that funds contribute to the objectives of the EU budget. Moreover, it will be important to establish rigorous anti-corruption measures including requirements to pay back EU funds in case of irregularities and the imposition of penalties if structural misuse of

[16] Reuters (2018), **Macron pushes for EU minimum price for carbon**

[17] New Europe Online (2018) **MEPs recognize the importance of the EU budget in the transition towards zero-carbon economies**

[18] For investment challenge, see: EU High-Level Expert Group on Sustainable Finance (2018), **Financing a Sustainable European Economy**; see also: CAN Europe (2017), **More for more: How the EU budget can serve the achievement of 2030 climate and energy targets in line with the Paris Agreement**

[19] For E3G's asks, see: Gaventa (2018), **Five steps for a climate-friendly EU budget**

[20] See also: Hanoteaux for Bankwatch (2018) **EU should ensure sustainable cohesion policy**

[21] See e.g.: Seguin (2018), **Brussels concerned about misuse of EU funds in Hungary** and Rohac in Financial Times (2017), **EU funds to "New Europe" need better management**

funds is proven. Given increasing challenges with regards to the rule of law in parts of the CEE region, transparency of funding decisions grows ever more important. Recently, scandals in Hungary[22] and Slovakia[23] have drawn attention from across the EU and led to calls by several countries including Germany to strengthen controls over the use of EU funds.[24] This also resulted in the Commission's proposal for a new mechanism that will allow the Commission to withhold EU funding in case of irregularities and breaches of the rule of law when they threaten the financial interests of the EU.

Facilitate direct access to funding for regions and municipalities. To ensure access to support for small and medium-scale investors, municipalities and cooperatives, a share of funding to climate-related operational programmes should be reserved for technical assistance and community-based approaches. A strengthening of small-scale installations, e.g. through support of energy communities, can be a crucial factor for a rapid and decentralised energy transition. The example of Germany shows that broad participation of citizens strengthens the acceptance of renewables, fosters democratic and decentralised approaches, and distributes the economic benefits of the transition process more widely.[25] In addition, cities and regions are increasingly involved in climate coalitions, stepping up their ambition even in the context of complex constellations at the national level. Direct access to funding could be an effective tool to help them implement these ambitions.

Establish effective funding instruments for climate action and just transition. Climate-related activities in CEE are currently funded through various instruments, including the ERDF, the CF, the European Social Fund (ESF), the European Agricultural Fund for Rural Development (EAFRD), and the European Maritime and Fisheries Fund (EMFF). These five funds make up the European Structural and Investment Funds (ESIF). ERDF, CF and ESF are further tools for the EU's cohesion policy in less developed regions. With the European Fund for Strategic Investment (EFSI) and the linked European Investment Advisory Hub (EIAH), new mechanisms were set up in the context of the "Juncker Plan" in 2015 to leverage private financing, mainly through EIB investments. In the new MFF, these could be repackaged into a broader InvestEU instrument as proposed by the Commission. In the post-2020 MFF, these instruments should be strongly aligned with the EU's climate and energy policy, and a higher share of their financing should be earmarked for climate action.[26] The assessment of the effectiveness of initial EFSI spending is mixed. While 40% of funding went to climate-related purposes so far, recent research by Bankwatch suggests that EFSI provided only limited additional green finance and fuelled outdated carbon-intensive projects.[27] This shows that better design

[22] Rankin in Guardian (2018), **How Hungarian PM's supporters profit from EU-backed projects**

[23] Paravicini in Politico (2018), **OLAF examines alleged abuse of EU funds in Slovakia**

[24] Eder in Politico (2017), **Berlin looks into freezing funds for EU rule-breakers**

[25] For more information, see Jungjohann and Morris (2016): **Energy Democracy. Germany's Energiewende to Renewables**

[26] For E3G's asks, see: Gaventa (2018), **Five steps for a climate-friendly EU budget**

[27] See Bankwatch project on the **European Fund for Strategic Investments**

and spending modalities will be essential to make EFSIs an innovative, Paris-compatible funding instrument.

In line with the recommendations of the High-Level Expert Group on Sustainable Finance[28] and the European Commission's Action Plan[29], the **EU budget should strongly support and incentivise the greening of private investments across Europe**.

To ensure large-scale effective spending on climate action, a **single-purpose fund** for **climate** could be a powerful tool if it is complemented by a climate-mainstreamed budget and does not substitute higher climate ambition in other funding instruments. Further, a designated share of ESIFs or a single-purpose fund should ringfence a budget for the explicit support of **just transition**, ensuring the development of infrastructure and low-carbon job opportunities in (coal) regions whose economic base is bound to change drastically.[30] Funding for climate action and just transition needs to be linked to approaches involving local stakeholders in the design of regional, tailored solutions.

The **"Coal Regions in Transition Platform"** could be a suitable vehicle to address these challenges around a just transition, in particular for CEE.[31] The Platform is "designed to assist Member States and regions in tackling the challenge of maintaining growth and jobs" in communities affected by a future phase-out of coal. This assistance is supposed to include technical support when accessing EU funds for projects and activities supporting an economic diversification and the structural transformation to a low-carbon economy. Problematically, however, the Platform also foresees support for "clean coal" technologies that risk putting ailing coal plants on indefinite life support by moving EU funds into fossil fuels. Keeping coal alive artificially might look like an attractive option for many coal mining regions in CEE, but it would merely push the difficult decisions around an eventual coal phase-out into the future and, at the same time, reduce available funds for future-proof technologies. A just transition must embrace renewable energy-based solutions and prepare affected workers for jobs in industries other than coal. A broad range of options of using renewables-based electricity, heat, cold and steam locally has not been explored fully yet but would be the best possible use of just transition funds in the CEE region.

Build a designated revenue base for climate action in the regions. Environment and sustainability taxes such as a plastic tax, as suggested by Commissioner Oettinger[32], or a proportion of the EU ETS auctioning revenues, as suggested by the Committee on the Environment, Public Health and Food Safety[33], provide an opportunity to strengthen the funding base for climate action and related convergence across Europe. The Commission's initial proposal on both opportunities for own resources should therefore

[28] EU High-Level Expert Group on Sustainable Finance (2018), **Financing a Sustainable European Economy**

[29] European Commission (2018), **Sustainable Finance: Commission's Action Plan for a greener and cleaner economy**

[30] See also: Wuppertal Institute (2018), **Phasing-out Coal, Reinventing European Regions**

[31] European Commission (2018), **Coal Regions in Transition Platform Working Groups**

[32] Solletty in Politico (2018), **Plastic tax proposal faces resistance**

[33] European Parliament (2017), **Opinion of the Committee on the Environment, Public Health and Food Safety**

be welcomed.[34] As the UK's departure from the EU leaves a multi-billion-euro hole in the budget and European challenges such as migration, security and disaster response need to be funded, national finance ministers may prefer an EU levy on plastics or carbon rather than increasing their national contributions. If political backing for strengthened own sources can be secured, it will be essential that these policy instruments are designed in a way to guarantee stable revenues as part of a coherent EU climate strategy.[35] As regional development and cohesion policy could suffer budget cuts, an increase of earmarked own resources would be a suitable instrument to ensure sufficient funding for the low-carbon transition in CEE.

Ensure balance between interests of net payers and recipients. Voters in net payer countries such as Germany expect their governments to ensure that certain conditions are met if its funding is to be channelled to other EU member states. There are calls to link investment not only to performance, efficiency, and effectiveness, but also to cooperation on EU-wide asylum and migration policies.[36] Moreover, there are proposals to cut EU funding in countries where the rule of law and democratic values and institutions are being undermined.[37] While such conditionality will add further complexity to the negotiation process, it will be essential to tie funding decisions to compliance with good spending processes and effective implementation as well as coherence with agreed EU policy objectives.

Tailor funding programmes to high-carbon transition regions. A public interest case can be made not only for climate earmarking but also for scrutiny to ensure that the remaining EU budget supports rather than undermines the low-carbon transition. This is particularly relevant for regions which currently depend on coal mining and energy-intensive industries for their economic survival. Support for the transformation of their economies, for instance through targeted financial and technical support for start-ups and innovative, clean industries that can make use of the existing industrial infrastructure, will be of high importance. At the same time, training and reskilling measures for the workforce in declining industries will be essential. This needs to go hand in hand with investments in education and training facilities, the roll-out of broadband internet, public transport, hospitals and other public facilities to ignite the interest of potential investors in the regions. Additional criteria for EU funds should include elements of public participation to make sure that new investments meet the needs of the local population and civil society. Most importantly, however, such transformation programmes need to be embedded in a political process which will ensure the timely and orderly closure of the EU's coal mines and power plants.

[34] Reuters (2018), **EU sees 22 billion euros of new budget funds from plastics, CO2, corporate tax**

[35] See also: Gaventa (2018), **Can a tax on plastics and carbon fund the European Union?**

[36] Zalan and Maurice in EU Observer (2018), **Eastern states feel ridiculed by EU budget plan**

[37] Butler in EU Observer (2018), **Securing rule of law with economic power**

Efforts to maximise the impact and effectiveness of climate-related EU spending come with several **potential co-benefits which should be considered in the design and implementation of funding programmes**, tailored to regional and local contexts:

> *Air pollution and deforestation* are widely discussed environmental and health issues in many CEE countries, with major implications for local communities. Since most of the air pollution in CEE comes from burning coal, explicitly tackling this issue through EU funding priorities, for example by strengthening investments in energy efficiency and RES, can leverage the significant health and environmental benefits that result from such a transition.[38]

> *Cost savings, modernisation, and economic catch-up* can be reached through rapid investments in low-carbon energy infrastructure, energy efficiency, RES, and electric vehicle charging infrastructure. This would be well aligned with the Juncker Plan and national economic interests in CEE countries.[39] EU funding priorities should be more explicit about this link.

> *Europe's future competitiveness* in a world committed to rapid decarbonisation rests on research and innovation. Doubling the funds available for clean innovation in the next budget, as suggested by the High-Level Group on EU Research and Innovation[40], and identifying priority industrial decarbonisation challenges in CEE regions, linked to research, innovation, and deployment, would help Europe, including its member states in CEE, to be a global hub for green innovation in the future.

> *Energy and climate security*, particularly the dependence on fossil fuels, technology and funding from Russia, is a key concern across CEE. Instead of focusing on the exploration of new domestic resources or alternative suppliers of gas and oil, the rapid development of a RES-based energy system, accelerated by EU and domestic investments, would provide a more realistic and sustainable option to achieving energy security in Europe. Climate change is an increasing threat to EU security, with climate-related economic losses having doubled over the last 10 years.[41] Disaster-response needs to be adequately funded and linked to the development of climate adaptation strategies and action plans at Member State level. More fundamentally, all investments funded through the EU budget need to be resilient to more extreme climate conditions.

> *Just Transition:* Many of the regions that stand to lose out in the low-carbon transition need convincing roadmaps for the transition to a low-carbon economy. The current process around the Coal Regions in Transition Platform has the potential to help those regions come up with the right infrastructure investment

[38] The Economist (2018), **Why 33 of the 50 most-polluted towns in Europe are in Poland**

[39] See for Poland: Rissmann and Orvis (2018), **Tackling climate change in Poland: 40% fewer emissions, US$26 billion annual savings by 2050**

[40] European Commission – EURAXESS (2017), **Call to double budget for next EU research programme**

[41] European Environment Agency (2017), **Climate change, impacts and vulnerability in Europe**

plans as well as education and training priorities. EU funding programmes need to be made available to help those regions transition to a prosperous low-carbon economic future.

> *Deeper European integration:* EU funding is an opportunity to make the added value of the EU more visible and level the playing field between Western and Eastern Europe. All citizens of Europe have a right to be treated equally, and deserve clean air, water and soil. If this principle is positioned at the core of EU cohesion policy, it has the potential to not only foster climate action and environmental policy but also strengthen the support for EU institutions in member countries.

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About E3G

E3G is an independent, non-profit European organisation operating in the public interest to accelerate the global transition to sustainable development. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

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