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Internal and External EU Climate Objectives and the Future of the EU Budget

Abstract
The European Union has committed itself to a number of ambitious targets for greenhouse gas emissions reductions, renewable energy use and energy efficiency and the European Commission has recently also tabled very important proposals to develop to its potential the Strategic Energy Technology (SET) Plan. The reality on the ground, however, shows that the EU has been unable to play a central role in the climate negotiations in Copenhagen due to a lack of internal coordination, while the EU budget review is facing arcane difficulties to ensure that it focuses efficiently on objectives. This paper discusses what the role of the EU budget should be to assist in fulfilling those ambitions, in light of objectives related to climate change. It argues that the budget does not need revolutionary changes but specific reforms, some of which were already considered necessary before climate change became a priority. First, the budget needs to ensure that all expenditures are coherent with EU objectives. Second, the EU can have a very important role for changing the energy systems of the EU, due to the leverage role and financial engineering potential. It argues that by combining the EU budget to other funds, such as those from the EIB and through coordination with public and private actors, some crucial large-scale energy transformation can be achieved, i.e. the EU budget *can* make a difference.

Introduction
In May 2006 the Council and the Parliament requested the European Commission to present a complete review of the EU budget by the end of 2009, in line with the agreement on the Financial Perspectives in December 2005. In September 2007 the Commission launched a public consultation which lasted until June 2008. However, the long-awaited result of the review failed to materialise in 2009.

The review has not been a smooth process and various other events have affected it substantially. Since the review process started until the present day, the world has faced new complex challenges and the EU has adopted new important objectives. Those cannot be ignored in the review. Unfortunately, the challenges do not come with a clear manual on how to solve them and the role that the EU budget could or should play is very unclear.

How has the budget review been affected? The EU budget review until recently was still based mainly on a decades-old debate on very specific issues. Those were: a) how important should the CAP be in the EU budget? b) how should richer regions be treated in the cohesion policy? and c) should the EU budget be financed by a clear European real Own Resource (i.e. tax)? The debate was only slightly updated with some additions,

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namely the search for more European Value Added in the EU budget, a better definition of public goods and seeking more emphasis on fostering growth at European level, namely through the support on research and development (R&D) and some other interventions.

In the last three years many events have sparked a serious debate on the role of the EU budget in other areas. A global food crisis was soon followed by a global financial crisis; climate change has taken a central role in world politics and the EU has adopted ambitious objectives aimed at reducing greenhouse gas emissions. Finally, and very recently, a Copenhagen Accord was adopted in the UNFCCC climate negotiations which could have repercussions on the EU budget, in particular for the external action budget.

Those events are having important effects on the budget review process. Most recent debates on the reforms seem already to be out of touch with the present circumstances. To complicate matters, a new report by Fabrizio Barca[1] introduces serious new issues into the debate, namely important aspects on the territorial approach of the Cohesion Policy, needed important reforms in the EU and national institutions, and a serious question on the role of social policies. Many of the fundamental questions raised in this report were not touched by a leaked version of the budget review.[2] All those factors may be the reason why the budget review has been delayed indefinitely beyond the end of 2009.

Recently, CEPS has published a comprehensive report on the role of the EU budget in climate change.[3] This comprehensive report aims at offering a thorough analysis of the conformity of the present EU budget with the EU's climate objectives, its coherence with national policies and some clear practical changes. This policy brief will draw heavily from this report but will add some additional insights based on the Copenhagen Accord which was drafted in the latest climate negotiations and some points from the recently published 'EU 2020' strategy[4] and the Swedish Presidency non-paper on eco-efficient growth.[5]

This policy brief seeks to present a list of clear areas where the European Union budget could play an important role in the climate and energy policies, to a certain extent independently, on how the budget may change in shape, financial size or emphasis. Some proposals are essential requirements which need to be integrated horizontally into the different budgetary policies. The recommendations are based on a careful reflection of the role the EU budget can and should play, not because climate policies are fashionable and politically correct, but because many synergies can be found between climate and energy policies, growth, employment and green jobs, environment and international competitiveness and trade. The EU budget is a small but powerful tool to mobilise and coordinate European actors and this opportunity should not be missed. In fact, the EU budget through its leverage mechanism, its importance in many regions and the rules governing it (such as procurement procedures) has the potential to exert a strong influence over investment decisions by governments and individuals. This potential influence has never been properly exploited and has often been undermined through badly targeted policies.

The undermined power of the EU budget

This policy brief argues that the EU budget is a much more powerful tool to assist the EU to reach specific objectives than it is credited for. The EU budget is certainly very limited in size, a feature which is unlikely to change significantly.[6]

However, the EU budget has the potential to reach far beyond its size. Through its leverage mechanism, i.e. the co-financing of projects, it mobilises public and private additional investment and can generate economies

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[1] Barca, F. (2009), 'An Agenda for a Reformed Cohesion Policy, A place-based approach to meeting European Union challenges and expectations', Independent Report prepared at the request of Danuta Hübner, Commissioner for Regional Policy, European Commission, April 2009.

[2] http://www.euractiv.com/en/priorities/brussels-plans-major-review-eu-spending-priorities/article-186753, last accessed 15 December 2009.

[3] Núñez Ferrer, J., Behrens A. and Egenhofer C. (2009), 'For a sustainable, competitive and greener EU budget – Integrating the Climate Change objectives of the EU', Task Force Report, CEPS.

[4] 'Consultation on the Future "EU 2020" strategy', COM (2009) 647 final, Brussels, 24.11.2009

[5] 'Eco-Efficient Growth in the Age of Globalisation', Swedish non-paper on the Lisbon strategy post-2010.

[6] With 'significantly' the author means more than a doubling of its size as share of EU GNI.

of scale at European level. In addition, the use of EU funds combined with financial engineering can expand the scope and influence of the EU budget with minimal costs, increasing the level of venture capital from the private sector.

Such instruments exist, for example with loan guarantees from the EIB and EU funds for Trans-European networks, or through other programmes involving financial institutions such as the Jaspers, Jeremy, Jessica and Jasmine programmes.[7] The potential combination of EU grants from the cohesion policy with public–private partnerships (PPP) can also have the effect of multiplying the impact of the funds. All those opportunities are, however, underexploited. The European Commission itself and most member state governments are uneasy in using financial mechanisms which are not based on the straight offer of grants and direct public expenditure, due to the more complex administrative requirements of mixed systems.

In addition, the impact of EU funds has been strongly undermined by the influence of political agendas, rather than the achievement of solid socio-economic objectives. The value added of interventions has been largely eroded by a weak definition of additionality and a lack of enforcement of strategic objectives. The Common Agricultural Policy (CAP) has also contributed in tarnishing the image of the EU budget, first for the negative impacts of price support and later by granting subsidies based on historical production and by hectare, rather than by objectives and actual costs. The reasons are clear from a historical and political economy point of view and suit well the models based on political power[8] rather than objectives, but have reduced the confidence of member states (in particular net-contributors) on the EU budget's capacity to generate value added.
This is a clear problem, because the European Commission has launched a very ambitious, important and costly call for research and development with the SET Plan.[9] It also is preparing to request additional funds to complete the Trans-European Networks and finance external actions in the leaked budget review document which finally never saw the light of day. Without the member states' confidence in the European Commission's capacity to manage the ambitious programmes, there is little chance to move beyond the present budget structure and its failures.

Developing the EU budget's potential

There is a large scope to improve the EU budget's potential, without proposing a revolution of the budget to such an extent that it becomes politically nonsensical. Many of the EU budget's basic structures have been built on the right premises, but were never allowed to function properly. The EU budget is officially bound to principles of additionality, proportionality and subsidiarity, and requirements for monitoring and evaluation. In addition, strategic guidelines can have a strong effect on the way in which EU funds are used; this is the case with the Community Strategic Guidelines for the Structural Funds which allow the introduction of strategic objectives in the national programmes. All the cornerstones are there, but not well used, as mentioned in the Barca report.[10]

One of the first steps to reform the EU budget in line with EU objectives, be it on climate change, economic growth or environmental protection, is to review the mechanisms for the implementation of EU policies, the way national strategies are drawn and implemented, and the way the EU evaluates those. This is considered by the CEPS[11] and Barca reports as fundamental, but it is hardly addressed by the Commission's leaked budget review document, which lacked some inward looking.
While improving strategies and implementation quality is of crucial importance, there are changes in the

[7] These are the names of EU programmes using financial engineering to provide loans backed by EU funds.
[8] Kauppi, H. and Widgrén, M. (2005), 'Voting Rules and Budget Allocation in an Enlarged EU', Centre for Economic and Policy Research (CEPR) Discussion Paper No. 5134, CEPR, London.
[9] European Commission (2009), 'Investing in the Development of Low Carbon Technologies (SET-Plan)', Brussels, 7.10.2009, COM(2009) 519 final.
European Commission (2009), 'Commission staff working document – Accompanying document to the communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Investing in the Development of Low Carbon Technologies (SET-Plan)' – Impact assessment, SEC (2009) 1297.
[10] Reference in footnote[1].
[11] Núñez Ferrer, J. (2007), 'The EU Budget – The UK rebate and the CAP – Phasing them both out?', CEPS Task Force Report, CEPS,

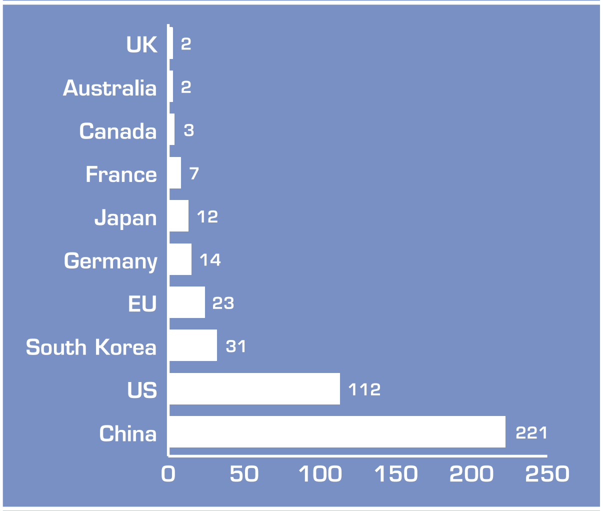
policies which are necessary to properly integrate climate change objectives into the EU budget. This is not only about creating specific policies for greenhouse gas (GHG) emission reductions, but to ensure that the policies are not contradicting EU energy and climate objectives and that all policies do take into account the need to reduce emissions and build climate resilience. In fact, most of the impact of the budget should not come from specific climate policies, but from the horizontal integration of climate needs across the budget.

Finally, before going into the specifics of the budget and climate change, getting the EU budget right means something more than improving its European value added, or focusing on other philosophical and theoretical concepts that are emerging in the discussions. The EU is facing a serious challenge in the race to keep a technological edge in the future. Large-scale green technology deployment worldwide offers a new opportunity to Europe's industry. Europe has, however, important and flexible challengers abroad, led by China and the US. Facing up to the challenge needs a competitive Europe that pools its knowledge and resources and leads the research and technological deployment in green technologies. Some member states of the EU and the European Commission have led the discussions on climate change and the diplomatic arguments to reduce emissions worldwide. However, internally the EU is not showing a unified drive in this area. The EU as a whole should reform its policies, at member state level and EU level to give our industries a better opportunity to compete in this technological race.

A comparison of the quality and structure of the recovery packages shows that China and the US have launched much more ambitious support through their green stimulus. Despite the EU's leading thinking in the area of climate change and the environment, it shows little actual engagement in practice with its stimulus packages. The EU effort is composed of separate, uncoordinated national interventions which are weakly targeted.

The European Commission's own stimulus package, worth €30 billion, is composed of rearranging existing funds from existing policies and using some EU budget margins.

International comparison of Green stimulus packages (billion US$)



Source: HSBC estimates

Europe's lack of a coherent unified policy, the uncoordinated public financial efforts in the area of climate change and the disparate and badly reported national external expenditures in this area are the fundamental reasons for the failure of the EU to be a serious interlocutor in the Copenhagen climate negotiations.[12] Undoubtedly, we should not minimise the achievements of the EU, such as the agreement on the energy packages, climate objectives and the introduction of the ETS. However, those regulatory actions alone are missing some fundamental pillars. The ETS for example, can be undermined without a strong EU influence on emissions at global level and a strong and coherent green technology industrial policy.[13] If Europe has to be a global showcase and an important player, it needs a strong coherent effort by member states. This starts by restructuring national policies. The role of the EU budget is to provide a coordinated financial effort for a coordinated technology research, deployment and demonstration policy, a coherent external budget and a coherent climate policy approach in other budget interventions.

Promoting an energy revolution

The ambition of the EU in energy is to promote nothing less than an energy revolution, to achieve ambitious

[12] Egenhofer, C. and A. Georgiev (2009) 'The Copenhagen Accord – A first stab at deciphering the implications for the EU', CEPS commentary, 25 December 2009.
[13] Gross D. (2009), 'Why a cap-and-trade system may be bad for your health', CEPS Commentary, 11 December 2009.

emission reductions and increase energy security. The energy and climate change package has as an objective to reduce emissions by 20 per cent by 2020 (up to 30 per cent in the case of similar efforts by other industrialised countries) and by 60–80 per cent or more by 2050, combined with important renewable energy and energy efficiency targets.

Background infrastructure:
The EU budget has the potential to intervene in crucial aspects of these objectives through a number of policies. In the forefront is the completion of the Trans-European Networks (TEN) for energy, necessary to create a single energy market and to develop the full potential of renewables. Particularly important is the completion of the interconnectors among member states. The TEN plans were not developed to address today's energy concerns as the Second Energy Review clearly states (European Commission, 2008) and we are far from a coherent development of an integrated grid.

For the EU to achieve its full potential with large-scale renewable energy sources, it is important to build the infrastructure that would counteract the fluctuations of energy intensity arising from those sources. It is important that HVDC (High Voltage Direct Current) connections link member states to large renewable energy sources. This allows long-distance energy transfer with low levels of energy loss, minimising the need for backup energy and linking the best renewable energy locations – sun from the south and wind and hydro from the north.

Leading the technological race:
As mentioned earlier, China and the US are quickly moving to take the edge in green technologies. The EU has not moved the same amount of resources in this direction, nor does it seem to have an appropriate internal policy structure to react fast.

To compete, the EU needs to bring up to speed its combined public and *private* R&D in a coherent fashion. One of the stumbling blocks is in fact a low level of private R&D which seems to be related to national regulatory and tax aspects in many member states,[14] thus an increase in the public research investment is not enough.

Nevertheless, the EU budget in R&D needs to increase. The Commission proposals for the SET Plan seem to point in the right direction, although the actual performance of the many technology platforms and initiatives will require some serious planning. The EU budget will have an important role to help finance technologies which are too risky for private companies to undertake alone, or where the time for a technology to reach a profitable deployment is too long. Financing large demonstration projects for new technologies will be an important part of the EU's role. In some cases, where the demonstration involves the deployment of new energy systems at regional level, the R&D funding could be combined with other funds, such as regional funding to develop showcase low-carbon zones. Changing energy systems combined with energy efficiency and energy-saving technologies could bring important benefits for whole regions, developing new economic activities and green jobs, and reducing energy poverty for disadvantaged groups of society in those regions. In regions where the infrastructure is weak, usually in poorer EU member states, the opportunity costs of replacing those with new technologies, some of them at demonstration stage, are low. A synergy of policies can foster technological innovation and help the EU to lead the new modern technological race by innovation and example. The creation of low-carbon zones is an opportunity not to be missed.

To take advantage of such opportunities, there is a need, however, to improve the strategic planning and implementation capacity in member states and the European institutions. Many are ill prepared to handle such complex multi-annual 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, financial institutions and wider civil society is for many administrations unprecedented. Here, as in so many other areas of public intervention, be it at EU or national level, there is a large scope to explore new forms of public–private partnerships.

[14] See Uppenberg, K. (2009), R&D in Europe: Expenditures across Sectors, Regions and Firm Sizes, CEPS and the European Investment Bank, Brussels and Luxembourg; or Wiesenthal, T., G. Leduc, H.G. Schwarz and K. Haegeman (2009), R&D Investment in the Priority Technologies of the Strategic Energy Technology Plan, JRC Reference Reports, Joint Research Centre, European Commission, Luxembourg: Office for Official Publications of the European Communities.

Reducing emissions

The previous section on promoting an energy revolution is clearly aimed at reducing emission, combining it with the need to be at the top of new developments in global innovation.

However, the wider EU budget's role in fostering a reduction in emissions is very important. The EU's Cohesion Policy, consisting of the Cohesion Funds and Regional Funds for regions with a low GDP per capita relative to the EU average, and the CAP, have important impacts on the behaviour of beneficiaries.

For the Cohesion Policy, it is important that the actions it finances are coherent with the EU's climate objectives. First, there should be a stronger emphasis on public transport and rail connections, rather than the strong focus on roads and motorways, preferred by governments for their fast development and their large absorption of funds. All actions should avoid clashing with EU climate objectives. Financing of road infrastructure should be followed with requirements of introducing charges on the use of roads, for example, and the introduction of incentives to use rail systems. Many member states have, for example, refused to introduce the Euro-vignette to charge for road use.

All projects financed with EU funds should also require high standards in the emissions impact of projects, be it in the realisation, such as the materials used, or the final activates promoted by the project. The public procurement rules for EU-financed projects need to require those standards from contractors. The effects can be very important in promoting a change in business practices. For coherence reasons, national public procurement rules tend to follow and apply the same rules.

On a very practical level and for an important source of emissions, the EU funds should increase the assistance to waste management in the regions it supports. Waste is a large emitter of the very powerful greenhouse gas methane; reducing those emissions can have a very fast impact in reducing the accumulation rate of GHG in the atmosphere, reducing future temperature impacts. Waste management technology exists, and it is easy to implement and has other large beneficiary effects on the environment and health. This should be promoted now and in the next Financial Perspectives. All member states should address the processing of waste.

For the CAP, there is a need for a reform to change the way the sector is supported. The present payments to farmers are based on parameters completely unrelated to either their incomes or the costs of any environmental practices implemented. Direct payments to farmers are based on area payments linked to production two decades ago for older member states and for a defined period in the new member states. Payments are highly unequal and regressive and should be reformed by decomposing them into specific social and environmental payments, such as income support based on actual farm incomes (total income including non-farming activities of the business) and payments to cover the costs of implementing specific environmental practices of wider public importance. This should allow funding to be better focused and more cost effective.

Changes in land use practices can have a large impact in GHG emissions and even carbon capture. Novel technologies such as the use of Biochar[15] for carbon capture can have important implications. The possibility of allowing farmers to join the ETS to sell their captured greenhouse gases should be explored.

Finally, for the EU budget to develop its real potential there is a need to liberate it from the financial and political constraints caused by the large share of funding to agriculture. In large part, this is caused by the refusal of some member states to allow the EU budget to work as a leverage tool only, i.e. for co-financing. The CAP should be based on a system of co-financing which reflects the financial capacity of member states. Poorer member states should be supported more to implement EU-agreed subsidy levels.[16]

Building climate resilience

The EU budget can play a role in increasing climate change resilience, i.e. adapting to climate change. Partly, this can be achieved by ensuring that expected climate changes are taken into account in the planning of projects financed by the EU. For example, when devising new energy systems in EU regions, the expec-

[15] Marris, E. (2006), 'Black is the New Green', Nature, Vol. 442, No. 10, pp. 624–626.

ted changes in the water levels in the future need to be taken into account. Even solar energy systems, for example, often need large amount of water to transform solar heat into steam to run turbines or to keep panels clean.

For agriculture, the need to develop resilience is important. Care has to be taken that EU funds are not directed into a blind support to compensate farmers for being located in areas where farming becomes unprofitable due to a higher incidence of drought or flooding. Also, new systems need to be devised to create private insurance mechanisms with a state guarantee element for events which are uninsurable. In general, the EU and member states should be learning to make better use of the opportunities from different forms of public–private partnerships.

Assisting developing countries

One of the only clear commitments (or maybe the only one) of the Copenhagen accord, is the requirement for developed countries to mobilise new funding of 30 billion US$ a year for developing countries from 2010 to 2012 and increasing this to a 100 billion US$ by 2020. The funding should be from a number of sources, not only public. Nevertheless, the EU will be an important contributor to the financing of this effort and public fund requirements will be high.

There are many issues that will need to be addressed, including who will manage this funding and how it will be used (the Copenhagen accord mentions an international Green Climate Fund, without any specifics). But for the EU, there is a strong question on how its share will be raised and how the EU will influence the use of the money through the Green Climate Fund. The EU's policy cacophony in external action can only help in leaving the real influence over the Green Fund to the US. Member states may, of course, want to contribute independently and try to play independent fiddles, but there is little chance that this would exert any counterweight to the US on setting the agenda for the funds. The EU should have one clear representative on climate change, in the same way that the EU handles trade negotiations through the trade Commissioner. The Commissioner responsible for climate change should represent the EU in the negotiations, if the EU does not want to be sidelined again on climate change, as happened in Copenhagen.

The EU member states should also agree a clear method to provide this funding, and the EU ETS is, for the moment, the best candidate in this respect.

Conclusions

The EU budget is an important EU instrument, because it can, through its leverage mechanism, influence investment decisions across the EU and create economies of scale through pan-European collaboration. The reforms proposed in this paper do not require a revolution in the budget and the creation of new and complex headings. Only for research and development and external action are the requirements important deviations from the present budget.

For R&D, it requires more funding, more coherence and more collaboration to ensure that the EU takes a lead in the global race to develop green technologies for the present and the future. Member states, however, should look into their own policies, in particular the underlying reasons for the EU having a weak level of private R&D compared to the US or Japan.

Another important change is for external action on climate change. For the moment each member state has its own external action and budget in this area. The lack of a clear EU policy, the unclear budgetary resources the EU as a whole is using and the lack of a central figure representing the EU at negotiations, clearly has negative implications. The EU should have one financial channel and one voice if it wants to influence the Green Global Fund proposed in the Copenhagen accord and any future climate negotiations. The accord calls for *new and additional* resources to finance global action for climate change. The EU has a very good instrument in place to raise those funds, i.e. the ETS.

Important reforms are proposed in this paper for the agricultural sector, however, most are not related to climate change, but to the policy's detrimental effect on the functioning of the EU budget. The proposals are

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[16] Núñez Ferrer, J. (2008), 'Can reforming own resources foster policy quality?', SIEPS, working document No 3, www.sieps.se

to release the EU budget from the present stalemates by finding a way to finance the policy differently and improving targeting. Climate policy is part of the targeting reforms which should occur anyway. The only more revolutionary idea is to explore the carbon capture potential of land management and maybe the introduction of agriculture into the ETS carbon market.

For other areas, there is no need for revolutions, but streamlining and making EU interventions compatible with objectives. In particular, the TEN-E interventions need to be increased to ensure the creation of a single European energy market which is compatible with the large deployment of renewable energy systems. Without this, reducing emissions in the energy sector and increasing energy security will not be achieved efficiently.

The Cohesion Policy should be integrating climate concerns into its operations. The EU public procurement rules also have a role to play, requiring high standards for the construction methods, materials and the level of emissions of activities promoted by the final projects. In addition, there are potential opportunities to use regional funding in coordination with research funding and other sources of funding to create low-carbon zones. This has to be explored.

The EU budget is an important instrument and a beacon of European ambitions. Its functioning and impact should reflect the objectives of the EU. This is not only an image issue, it is also because the EU budget has a strong potential through its leverage instruments which have never been fully exploited due to a lack of coherence, effective strategic planning and monitoring. We have a new opportunity to generate large economies of scale and to mobilise the EU's research and business potential with well-targeted and still relatively limited levels of funding through the EU. It would be another important blunder of the EU to fail to do so; a blunder it can hardly afford.