

When Financial Needs Meet Political Realities: Implications for Climate Change in the Post-2013 EU Budget

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Key Messages

- The post-2013 EU budget needs to engage more with strategic issues critical for Europe in the coming decade, including combating climate change and building a green economy.
- The scale of investment needed to kick start the EU's transition towards a greener and more competitive future is enormous. Early Member State and EP positions suggest that discussions could quickly get bogged down in historical stalemates while critical issues of policy objectives, priorities and content might get neglected.
- There is a clear need for an institutional champion who places climate change at the heart of the future budgetary negotiations and defends it as a 'no-compromise' issue, in the interests of Europe's citizens. Given the new institutional framework for decision making and its previous role in advancing the EU's climate change agenda, that champion could be the European Parliament.
- There are still opportunities to create a stronger political commitment for change particularly with regard to setting out an overarching framework and performance criteria for investment and mobilising innovative financing instruments for sustainable, low carbon development.

On the eve of budget proposals

Over the last two years, there has been growing recognition that the EU budget after 2013 needs to engage more with those issues which are going to be critical for Europe in the coming decade. These include combating climate change and building a green economy. We are now approaching the time when negotiations on the future long-term EU budget begin in earnest, and the willingness of the European institutions to align the EU budget to new priorities will be tested.

The European Commission is currently in the process of preparing its proposals for the post-2013 EU Multi-annual Financial Framework (MFF). The MFF will be a key mechanism for driving transitions in the European economy and building new capacity in the Member States. A first legislative proposal on the draft MFF Regulation is expected to materialise in

early July and will be followed by separate legislative proposals on the different funding instruments such as the Common Agricultural Policy (CAP) and Cohesion Policy towards the autumn. Once the proposals are published the ball will roll into the hands of the Council and the European Parliament (EP), which will embark on what is likely to be a contentious and lengthy negotiation process. The MFF Regulation is expected to be agreed by the Council under the Danish Presidency (first half of 2012) while agreement with the EP is expected to be confirmed under the Cypriot Presidency (second half of 2012). The Polish Presidency (July-December 2011) is expected to coordinate the preparatory work for this.

The negotiation process could be fraught over the coming year. On the one hand, several Member States have adopted firm positions in favour of the status quo or a smaller budget. Historically this has created a number of impasse situations and an inherent aversion to reform in the system. On the other hand, the Lisbon Treaty has changed inter-institutional relations between the Council and the European Parliament (EP) with regard to the procedure on agreeing the budget, bringing uncertainty about the roles and competencies of the different EU actors in the process of finalising the MFF. The Hungarian EU Presidency is still working on achieving a joint understanding on this matter.

This policy brief considers two issues:

- The ***scale and urgency of funding requirements*** for a low carbon transitions which have become clearer with a succession of new studies being published; and

- The ***readiness of the EP and national governments*** to address the issue at a time when other preoccupations are prominent on the political agenda. The EP has a unique opportunity to take a more strategic view in the negotiations and some of the early signs from leading Committees in the EP in this regard are encouraging.

The scale and urgency of investment needs for the low-carbon transition

In broad terms, current spending for climate change through 'mainstreaming' in funds such as the CAP and Cohesion Policy over the 2007-2013 period amounts to about 5 per cent of total outgoings or some €50 billion (€7 billion annually) mainly through investment in clean and efficient transport and energy systems and a smaller sum through eco-innovation and research. Given the gravity of the challenge ahead, the contribution of the EU budget seems close to miniscule. However, while recognising that the EU budget can contribute only modestly to the full scale of the investment needs, it can play a critical role in providing a coordinated framework for investment and help to build a new orientation in the EU. Therefore, significant changes in the post-2013 EU MFF will be necessary. Table 1 illustrates this challenge with an overview of some recent estimates of investment needs, particularly in the fields of renewable energy supplies and energy conservation.

Table 1: Estimates of the scale and scope of financial needs for the low-carbon transitions by 2020 and beyond

Document / institution	Fin. needs	Timeframe	Description
European Union			
Roadmap: Low carbon economy by 2050 (2011)	€270 bn p.a.	2010-2050	Additional €270 bn p.a. over the next four decades (public + private investment). In the next 10 years, €200 bn for the refurbishment of existing building stock alone.
EU Transport White Paper (2011)	€1,000 bn	2010-2030	Cost of EU infrastructure development to match demand for transport is estimated at €1,500 bn for 2010-2030. Completion of TEN-T network €550 bn by 2020. Additional €1 trillion may be required for investment in vehicles, equipment and charging infrastructure to achieve emission reduction goals for transport sector.
EU SET Plan (2009)	€8 bn p.a.	2010-2020	€8 bn p.a. for RD&I over the next 10 years to move forward key actions in the SET Plan. This would represent additional investment of about €50 bn by 2020 (public + private investment).
2020 Energy Strategy / Energy infrastructure priorities 2020 and beyond, (2010)	€1,000 bn	2010-2020	€1,000 bn needed up to 2020, of which €200 bn for transmission networks, diversify existing sources, replace obsolete capacity, modernise and adapt infrastructures, increasing and changing demand for low carbon energy. Estimated investment gap of €60 bn likely to remain by 2020 due to non-commercial positive externalities of projects and risks of new technologies.
Move beyond 20% GHG emission reductions (2010)	€81 bn p.a.	2010-2020	In 2008, the cost of the 2020 20% GHG emission reduction target was assessed at €70 bn p.a.; in 2010, the cost estimate dropped to €48 bn. If the EU opts for moving to a 30% target, the total cost of the EU climate and energy package is estimated at €81 bn p.a. by 2020, or 0.54% of the EU's total GDP.
Progressing towards the 2020 target, (2011)	€70 bn p.a.	2010-2020	Annual capital investment in RES needs to reach €70bn to meet the EU 20% renewable energy target by 2020 (annual capital expenditure in 2008 was about €35 bn). Half of this is to target offshore/onshore wind energy and solid biomass.
Scaling up int. climate finance after 2012 (2011)	€31.5 bn p.a.	2010-2020	International financing of USD 100 billion required p.a. by 2020 – of which the EU share could be about 1/3, thus roughly about USD 33.3 billion (€31.5 billion).
Adaptation measures in electricity, (2011)	€41 bn	2010-2050	Adaptation costs in 2050 for hydroelectric power and other renewable energy sources will be €20.6 bn and €20.4 bn respectively. This compares with €6.6bn for nuclear power and €8.8bn for plants using fossil fuels.
Industry			
EREC – Re-thinking 2050 (2010)	€1,180 bn	2010-2050	By 2020, total cumulative RES investments will be €963 bn going up to €1,620 bn by 2030 and €2,800 bn by 2050. These are expected to be off-set by the avoided CO ₂ costs alone. Additional cumulative capital needs will rise from €660 bn in 2030 to more than €1,180 bn in 2050.
EWEA – EU Energy policy to 2050 (2011)	€6 bn	2010-2020	The European Wind Initiative, part of the EU SET Plan, is the high-tech roadmap to develop new wind energy technology, testing facilities and streamlined manufacturing processes. It requires a yearly investment of public and private resources of approximately €600 million by 2020.
European Network of Transmission System Operators for Electricity	€23-28 bn	2010-2020	Excluding national and local investments, transmission system operators intend to build or refurbish just over 40,000 kilometres, or 14%, of the existing European transmission grid by 2020. This represents a total investment of €23-28bn, €12-14bn of which will be used to fund a super grid for offshore wind power in the North Sea.
NGO and other estimates			
ECF Roadmap 2050 (2010)	€30-50 bn p.a.	2010-2050	€30-50 bn p.a. of additional funds required for energy generation capacity and grids. Funding is required for new investments in energy efficiency measures, heat pumps and alternative drive trains, which may add up to over € 2-3 trillion over 40 years.
Greenpeace and Energynautics (2011)	€581 bn	2030-2050	€581 bn needed in EU between 2030 and 2050 to supply nearly 100% of electricity needs with RES by 2050. This is according to a 'high grid' scenario where the European grid is connected to solar power installations in North Africa. Transferring large amounts of solar power to the EU are expected to lower electricity costs.
Project Catalyst (2009)	€95-130 bn p.a.	2010-2020	If EE savings are not counted and transaction costs are included for the whole set of abatement opportunities, the incremental cost of achieving a 450 ppm path is €55-80 bn p.a. for developing and €40–50 bn for developed countries (< 1% of global GDP) between 2010–2020.

Source: Own compilation

It is difficult to put forward one single figure that will capture the overall scale of the diverse requirements to build a low carbon economy since the estimates presented are not directly comparable, often referring to different time periods for example. Some are drawn up on the basis of total present values while others on average investments per annum. Most studies are very much energy supply focused but this does not mean that this is the single most important sector for action. Rather, it reflects the fact that there is less data projecting future needs for many of the other sectors (e.g. transport planning, upgrading building stock, etc.). Furthermore, such projections tend to focus on climate mitigation measures while estimates associated with avoiding and adapting to climate change impacts and severe weather events are only now being developed. In any case, the different governmental, non-governmental and industry sources point to the same conclusion - ***the scale of the necessary investments appears to be significant***, which implies that a strong injection of finance is required from both private and public funding sources.

The studies underlying these estimates also indicate that the ***mobilisation of substantial amounts of resources cannot be postponed without considerable cost since the success of any long-term efforts greatly depends on the outcome of short-term actions***. For instance, although current investment patterns are found to have facilitated considerable growth in the renewable energy sector, this growth is unevenly distributed between EU Member States and total investment streams remain fairly low compared to what is needed to reach the

EU's 2020 renewable energy (RES) target. The financial gap for meeting the RES target alone is estimated to amount to €25 to 35 billion per annum in the period 2011-2020.¹ Any failure to deliver short-term commitments will inevitably affect the EU's ability to deliver the decarbonisation agenda in the long-term. At the same time, there is growing evidence that ***delayed climate action is likely to lead to economic losses***. The European Commission estimates that delaying climate action is likely to cause an increase in eventual investment requirements of around €100 billion per annum between 2030 and 2050 without a comparable decrease in the investment needs before 2030.² The International Energy Agency notes that every year of delayed action to limit climate change to 2°C adds an extra USD 500 billion to the investment needed.³

It must also be recognised that ***while the challenge seems enormous, timely actions can mitigate cumulative costs***. There are potential savings that can be realised by early and targeted investments in climate change action and technologies. For example, it has been estimated that a 10 per cent increase in the share of renewable energy in the European supply mix could avoid future GDP losses in the range of €20-36 billion in the EU and offset approximately one-fifth of the renewable energy investment needs up to 2020.⁴ As far as transport decarbonisation is concerned, an OECD paper has argued that an effective mix of technology and fuel related GHG emission reduction measures are relatively low cost or may save money over time due to their potential to reduce fuel consumption.⁵ If the further benefits to air quality, ecosystem resilience, health and energy poverty of a change in energy

structures and other greening measures are taken into account, the transformation agenda appears more feasible and politically becomes much more appealing in the context of calls for a greener and competitive economy.

The question is whether EU politicians are willing and prepared to walk the talk and place the low carbon transformations agenda at the heart of the post-2013 EU MFF. The answer to this appears to be shifting as the vital political debate gets closer.

Mapping political currents

The political position of the major players on the future EU budget can and will change over the next few months. However, from initial indications, rather few Member States have come forward with positions in favour of a strong climate strand in the next MFF. Currently, the *political preparations for the EU budget negotiations do not seem to reflect the scale of the challenge*. The role of the European Parliament is therefore very important and their view is likely to develop considerably over the next six months.

Aligning the EU budget to new overarching political priorities (and competences as enshrined in the Lisbon Treaty), such as climate change, requires both vision and a willingness to adopt a fresh approach. However, EU budget negotiations have historically tended to follow path dependencies focusing on issues such as national net payments and correction mechanisms rather than priorities for action and delivery of policy objectives.

Amongst the Member States, caution has been the watchword and, quite predictably, national preoccupations are visible when public statements are made or less formal political positions are alluded to. For the moment, public champions for greening the EU budget and embedding the climate agenda in future funds have been rather scarce.

One prominent group of Member States has argued for an effective freezing of the future budget. While this constrains the scope for addressing climate priorities to some extent, it certainly does not eliminate it. Indeed many supporters of a smaller budget also consider that climate objectives merit more prominence in the budget. Within this group, the **UK** has given several indications of its support for a greater climate focus in the budget which has been helpful. However, it has simultaneously made plain its determination to defend its national rebate as a core political objective which has weakened its leverage in the overall debate. The **Netherlands** also plans to strongly stand behind their own rebate and **Denmark** announced it will demand a €1 billion rebate from the EU budget post 2013. However, it is also amongst the countries sympathetic to the climate issue in the budget.

France and the Netherlands have both shown sympathy to a climate dimension of the budget but at present appear to be giving priority to defending the CAP budget. Furthermore, domestic politics in France are currently dominated by the approaching presidential elections in May 2012. President Sarkozy is seen as wanting to defend his rural voters and is likely to sacrifice other aspects of the EU budget in an effort to defend a sizeable CAP budget. **Germany**, potentially a

pivotal actor in this debate, has shown leadership in the European and national climate policy arena but thus far in the budget debate is better known for espousing the ‘three nos’ – no increase in German net payments, no reduction of Cohesion Funds and CAP payments, and no EU tax.

Moving eastward, **CEE countries** seem to be most interested in receiving their ‘fair share’ of the Cohesion Policy pot and hence are likely to resist any attempt for a reform which would entail a reduction of this major budget line. **Poland** as the next EU Presidency is faced with parliamentary elections in the autumn, meaning that domestic political pressures are likely to see the government inclined to defend regional and agricultural interests rather than climate measures. Importantly, Poland has so far maintained strong opposition to any attempt to link the EU budget debates to climate change and particularly to moving to a 30 per cent emission reduction target for the EU by 2020.

On the Parliament’s side, the recent **SURE Committee report** adopted on 25 May⁶ can be seen as an encouraging starting point. It calls for a 5 per cent increase in the level of resources for the next MFF, dedicated to measures intended to achieve the ‘Union’s objectives and commitments’ (among which are promoting renewable energy technologies, energy efficiency and energy saving, R&TD in the field of energy and international climate finance for developing countries). This is quite promising for the long-term climate change agenda as it means that stepping up funding for climate change could become one of the Parliament’s main bargaining chips in the forthcoming

budgetary negotiations. Other key demands include a new system of own resources for the EU and the scrapping of all national rebates. This will no doubt provoke strong reactions from key Member States and climate change will not be the only topic in the limelight.

It has yet to be seen how far the Parliament may seek to pursue a bigger role than the one set out in the special legislative procedure in the Treaty (according to Article 312 of the Treaty on the Functioning of European Union, the Council shall act unanimously after obtaining the consent of the European Parliament, which shall be given by a majority of its component members). Reimer Böge, a German centre-right MEP, warned in an interview that the Parliament would be ‘very stubborn in pushing its powers to get a greater say in the negotiations’⁷. There is a danger that the future negotiations might end up being dominated by a familiar inter-institutional muscle flexing exercise, reducing the discussions to a few deal breaking items. From a climate perspective, this could cut two ways. On the one hand, it could give more force to the Parliament’s views and to the priorities that they support. On the other, critical issues concerning policy objectives and content might be neglected. This would be a disappointment from the Parliament which as an institution has made a considerable contribution to advancing Europe’s climate agenda and would be a missed opportunity for it to take up the leadership role it is now well placed to play.

Discussion and recommendations

A month before the publication of the Commission proposal on the next multi-

annual EU budget, we are faced with a dilemma. The EU has committed to a long term decarbonisation agenda with concrete 2020 and 2050 targets (with a good possibility of moving to a 30 per cent emission reduction target by 2020) which will require considerable investment to be mobilised and new institutional capacity to be built in a range of institutions. While the EU budget has the potential to only pay a small portion of the full bill, the post-2013 MFF will be critical to set the right framework for future action and leverage additional monies from other funding sources. The analysis of Member States positions and the Parliament's demands to date however indicates that traditional issues (e.g. the total size of the EU MFF, CAP and Cohesion Policy, the national rebates and new sources of revenues) could too quickly come to dominate the debate. This could jeopardise the timely kick-start of a genuine decarbonisation agenda for the MFF.

Commission's President José Manuel Barroso has recently stated that the 'EU has to be equipped with a modern budget able to face today's challenges and to invest in the future'.⁸ This is a bold statement carrying the promise of reform and a positive outlook. The next two years will offer a number of opportunities to the Council and the Parliament to propose their own version of the future. However, in order to overcome the political inertia of historical stalemates underpinning the EU budget negotiations there is a need for an institutional champion who will place climate change at the heart of the future budgetary negotiations and defend it as a 'no-compromise' issue.

From initial indications in the SURE Committee report, the **European Parliament** may be willing to take on this challenge. In fact, the Parliament is well placed to go beyond this and show stronger leadership in this regard. For instance, the negotiations on the separate funding instruments (e.g. the principal regulations on the CAP, Cohesion Policy, LIFE+) are to run in parallel to the MFF, offering opportunities for the Parliament to demand effective mainstreaming of climate change in these funds, both in terms of scaling up the necessary support but also improving the quality of spending. There needs to be consistency in such an approach. The Parliament's Environment Committee has just adopted a motion for a resolution on moving to a 30 per cent reduction target by 2020 (of which 25 per cent should be achieved domestically).⁹ This can be brought forward and reflected into the EP's position on the EU budget.

Overall, there is still time to create a stronger political commitment and consequently to create opportunities for change. Three in particular stand out:

- The future EU MFF Regulation needs to establish an **overarching framework for coordinated investment** in climate change. Coordinated EU action can realise important cost savings and hence reduce the total cost of low carbon transformations for the different Member States. Consideration should also be given to making room for climate related investment by weeding out forms of expenditure which have historically been commonplace but have counterproductive effects on the decarbonisation agenda;

- Given that the EU budget is relatively small and is unlikely to increase significantly, EU budget investments need to follow a **strict prioritisation**. A set of criteria needs to be developed ('beyond EU value added') to concentrate the scarce resources on measures that are of strategic importance, deliver climate policy objectives in the most cost-effective manner, act as catalyst for change and can be replicated at a larger scale under other financial instruments/schemes. Robust performance checks can be utilised to secure improved quality of spending and contributions to meeting climate change targets; and
- The EU budget needs to **mobilise additional financial resources** to complement traditional grants. Although innovative financial instruments have recently received considerable political currency, the knowledge base about the different options available and their relationship to the EU budget is still developing. Amongst the more interesting options currently being discussed is the blending of EU secured loans with grants for technical assistance and feasibility studies from the EU budget. In this way, the EU budget can contribute to the preparatory stages of the development of innovative low carbon projects and initiatives, which can then attract EIB/private financing for technological transformations or infrastructure development for example.

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