E3G

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A MISSION-ORIENTED BUDGET

PRIORITIES FOR THE MFF MID-TERM REVIEW

JULIAN SCHWARTZKOPFF, JONATHAN GAVENTA & QUENTIN GENARD

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About E3G

E3G is an independent climate change think tank operating in the public interest to accelerate the global transition to a low carbon economy. 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. In 2016, E3G was ranked the number one environmental think tank in the UK. **www.e3g.org**

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EXECUTIVE SUMMARY

The budget is one of the most powerful tools in the EU's political arsenal. How and where the EU spends its resources is a key test of its priorities. The EU needs a budget which reflects its future priorities, not its past political battles. Europe will not be able to safeguard its security and prosperity unless it realigns its spending with the challenges it faces. The EU budget needs to become more explicitly mission-oriented, focused and responsive. To achieve this, the mid-term review of the EU's Multiannual Financial Framework (MFF) should focus on:

Ensuring that the EU budget delivers on climate spending

The MFF review should reiterate the target for 20% of the EU budget to be spent on climate-related activity, and refresh EU systems for ensuring this target is delivered by giving an honest accounting of its climate related spending and ensure that an adequate pipeline of low-carbon projects is delivered.

Stop counterproductive high-carbon spending

The EU budget – inexplicably – continues to fund projects at odds with EU climate and energy goals. Project selection processes should be reviewed for consistency with wider EU policy objectives. In the context of climate policy, this means phasing out all high-carbon spending.

Refocusing the European Fund for Strategic Investments

The EU is losing its competitive advantage in the clean energy economy as investment has fallen significantly. The European Fund for Strategic Investment has been an early success of the current MFF. Its mandate should be extended – but refocused on EU strategic priorities.

Delivering a fair low-carbon transition

For the EU's approach on smart and sustainable growth to succeed, the social impact of the low-carbon transition must be taken into account. Establishing a dedicated Just Transition Fund could help achieve that.

Aligning Energy Union governance with the budgetary process

The infrastructure investments Europe needs can only come from a mix of public and private capital. The Energy Union governance framework can promote the long-term planning necessary to raise investor confidence – provided National Climate and Energy Plans are coherent and coupled with adequate financing strategies.

Enabling flexibility and responsiveness

The rigid MFF structure limits the ability of the EU budget to respond adequately to unexpected challenges. A misalignment between EU budget and political cycles exacerbates the situation. Greater responsiveness and flexibility is needed.

INTRODUCTION

When the EU's current 2014-2020 Multiannual Financial Framework (MFF) was agreed, the Council and European Parliament tasked the Commission with conducting a mid-term review in 2016. It was intended to assess internal and external challenges preventing the EU from implementing its budgetary priorities and address long-standing issues with the functioning of the MFF itself. This review is now nearing completion.

As it happens, unforeseen events like the refugee challenge or the compensation of European farmers in response to Russia's agriculture import ban have pushed the budget to its limits in only two years. The establishment of the European Fund for Strategic Investments (EFSI), while generally welcome, has added further pressure by reallocating already committed money.

Budget negotiations are notoriously tough. But the EU needs a budget which reflects its future priorities, not its past political battles. At the moment, the EU budget is spent on incompatible projects that pull in different directions. Unless the EU becomes more explicitly mission-oriented, focused and responsive and realigns its spending with the challenges it faces, it risks not being able to safeguard its security and prosperity in the world.

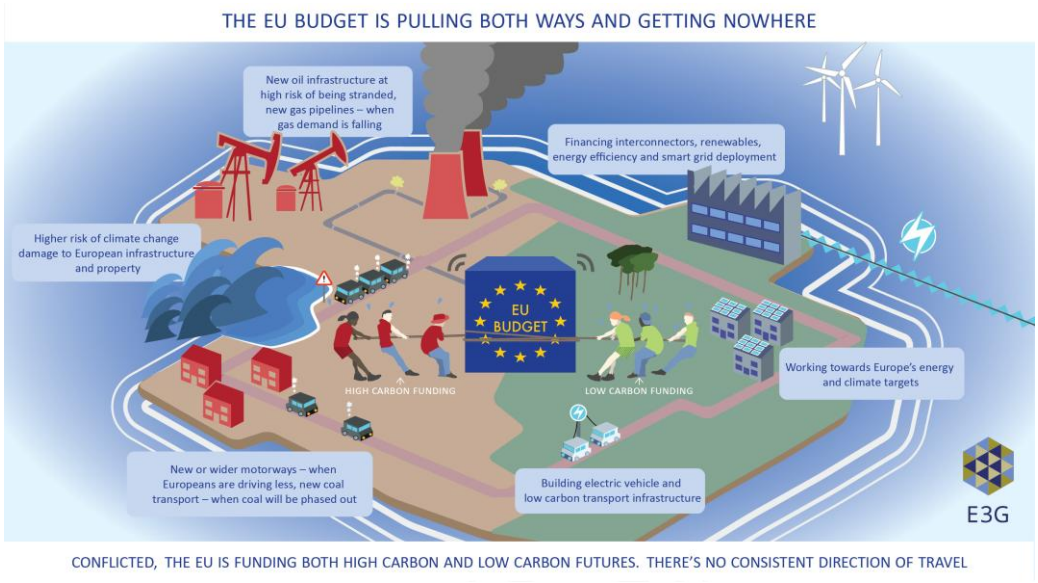
CHAPTER 1
A 100% PARIS-COMPATIBLE BUDGET

The 20%: Ensure the EU budget delivers on climate spending

With the current MFF, the EU has for the first time committed to dedicate 20% of its budget to climate-related expenditure. At roughly €205 billion for the 2014-2020 period, this is far from a negligible amount. It is a crucial tool for realising the low-carbon transition, boosting the EU's competitiveness in the international clean energy sector, as well as contributing to Europe's climate and resilience goals.

Currently, the EU is underachieving on its target to spend 20% of the MMF on climate. European Commission statistics show that only 16.8% (€27.3 billion) of the EU budget constituted climate-related spending in 2015, up from just 12.7% (€18.1 billion) in 2014. This share is expected to increase to 20.6% (€31.6 billion) in 2016.[1] While this looks like a success story, in reality these figures are seriously inflated.

Figure 1: An unfocused EU Budget



Source : E3G

Climate tracking follows an established OECD methodology, using "Rio markers" to indicate whether a spending area contributes 100%, 40% or 0% to climate action.[2] In principle, this is a practical and convenient way to track climate spending – but the

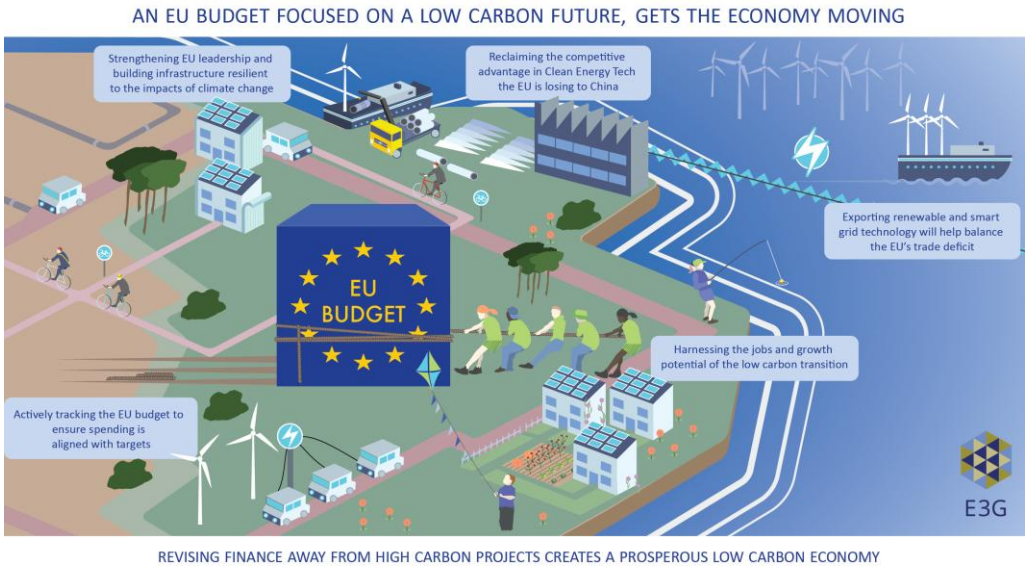
[1] European Commission (2015) **Climate Action progress report**

[2] European Commission (2015) **Climate Action progress report**

devil lies in the detail. Particularly egregious examples of misleading classification can be found in the Structural and Cohesion Funds, as well as the CAP, which together account for over 75% of all budgetary expenditure.

A large part of CAP spending, for example, is counted as climate-related expenditure even though the policy is criticised for promoting intensive and environmentally damaging farming. Under the European Agricultural Fund for Rural Development (CAP Pillar II) all spending on farm risk prevention, rural development or biodiversity is covered by climate tracking – even though the climate benefits are doubtful.[3]

Figure 2: A focused EU Budget



Source: E3G

The same goes for green direct payments to farmers under CAP Pillar I. The 2013 CAP reform introduced a requirement that 30% of direct payments had to be "green direct payments",[4] which were phased in over 2015-2016. These payments represent the EU's single biggest budget line with €42.2 billion in the 2016 budget and 30% of these are now counted indiscriminately as climate-related.[5] As a result, CAP reform is the main driver behind the EU's increase in climate spending, rather than for instance successes in ramping up spending in energy efficiency or renewables.[6] Between 2014 and 2016, while the EU budget's annual climate expenditure rose by €13.5 billion while green direct payments of €12.6 billion were phased in under the CAP over the same period.

[3] European Commission (2014) **Tracking climate expenditure**

[4] European Commission (2016) **EU annual budget life-cycle: figures**

[5] European Commission (2014) **Multiannual Financial Framework 2014-2020 and the financing of the CAP**

[6] European Commission (2014) **Annex V- Climate-tracking and biodiversity**; IEEP (2014) **Tracking system for climate expenditure in the post-2013 EU budget: Making it operational**

This is very problematic. Early indications suggest that member states are implementing green direct payments in a way that "rather than choosing to increase the environmental ambition on arable land […] provide the majority of farmers with the option to fulfil their […] obligations in a way that is likely to require very few changes in management".[7]

In the Structural and Cohesion funds as well there are many examples of the Rio marker categories being applied in a misleading manner. In Central and Eastern Europe, the majority of spending on renewable energy (counting as 100% climate-related) goes to biomass, which is typically used to upgrade coal power plants to enable biomass co-firing. Similarly, project funds to reduce air pollution (counting as 40% climate-related) are used to install pollution abatement equipment in coal power stations as well as install state-of-the art coal boilers for heating.[8] Part of the spending in these two categories, far from reducing CO_2 emissions, actually increases high-carbon lock-in by subsidising coal power and heat generation. More broadly, only 7% of allocated funds go towards energy efficiency and renewables projects in Central and Eastern European member states, despite the high growth potential in these areas (Figure).[9]

Even according to this flawed climate tracking methodology, the EU budget is still under delivering in key areas. In the Horizon 2020 budget, which has a separate 35% target, only 22% climate spending has been reached.[10] This is especially problematic as the Horizon 2020 programme is the most important vehicle for funding EU-wide research and innovation in clean technologies.

In sum, even though official figures suggest that the 20% climate spending target will be met for the first time in 2016 there is significant evidence to suggest that the true amount is significantly lower. Despite appearances, the current MFF is massively underperforming on climate spending.

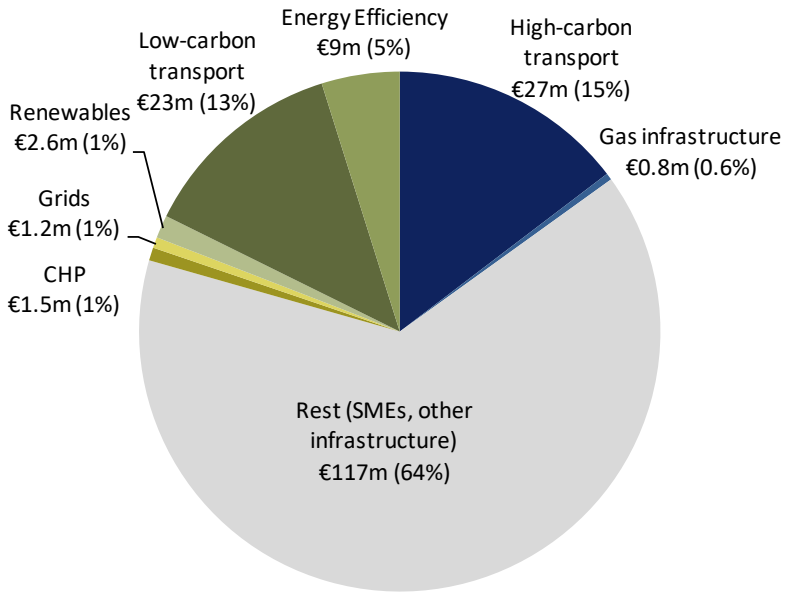
[7] IEEP (2016) **Scoping the environmental implications of aspects of Pillar 1 reform 2014-2020** and IEEP (2015) **Green direct payments: implementation choices of nine Member States and their environmental implications**

[8] CEE Bankwatch & Friends of the Earth Europe (2016) **Climate's Enfants Terribles – How new Member States' misguided use of EU funds is holding back Europe's clean energy transition**

[9] CEE Bankwatch & Friends of the Earth Europe (2016) **Climate's Enfants Terribles – How new Member States' misguided use of EU funds is holding back Europe's clean energy transition**

[10] European Commission (2015) **Climate Action progress report**

Figure 3: Distribution of Structural and Cohesion Funds in CEE (MFF 2014-2020)



*Source : **CEE Bankwatch**, based on European Commission figures*

This underperformance is certainly not due to an absence of need. The EIB estimates that the EU faces an annual investment gap of €100 billion to meet its 2030 climate and energy objectives, with 70% this investment needed towards energy efficiency.[11]

Similarly, this underperformance also does not appear to be due to an absence of potential climate-related projects. When the European Investment Plan was proposed in 2014, member states put forward €624 billion in low-carbon investment projects for consideration – or 44% of the total overall submissions.[12]

Instead, the key challenge appears to be one of governance and delivery. No overarching support structure has been put in place to build an adequate project pipeline, to aggregate and match climate-related projects to suitable funding streams and to ensure that mainstreaming is actually implemented in practice. This risks jeopardising the jobs and growth potential of the low-carbon transition.

The mid-term review of the MFF should therefore:

> **Reiterate the commitment to achieve 20% climate-related expenditure in the EU budget.**

> **Conduct a thorough review of the measurement methodology, applying the Rio markers in a much more focused and selective manner to make sure that no spending that is neutral or harmful to the climate is counted.**

[11] EIB (2016) **Restoring EU competitiveness 2016 updated version**

[12] E3G (2015) **Low-carbon demand and high-carbon risks in EU Investment Plan**

> **Allocate specific capacity to developing the project pipeline and ensuring EU budget lines and instruments are suitably designed for climate-related expenditure.**

The 80%: Remove counterproductive high-carbon expenditure

The EU budget is currently being allocated according to inconsistent priorities. While the EU is aiming for sustainable growth, parts of the budget support projects that actively undermine the achievement of Europe's climate objectives. Apart from realising 20% climate spending in the EU budget, the EU urgently needs to clean up the remaining 80% to ensure they don't negate its climate efforts.

Although both 2017 budget draft budgets put forward by the Commission and the Council[13] includes an explicit commitment by all parties to "make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"[14], large parts of the EU budget are doing the exact opposite. By continuing to pour money into high-carbon projects, the EU is sabotaging its own climate and energy policies, increasing its exposure to economic shocks, and building up an ever-growing stock of assets at risk of being stranded.

Funding of new gas infrastructure represents one glaring example of policy misalignment. The EU's main gas network development plan is not based on meeting the EU's climate objectives. In fact, it assumes 33-50% higher gas demand in 2030 that in a scenario where Europe achieves its energy efficiency targets. This has led to overspending on gas infrastructure particularly in the Connecting Europe Facility and Structural and Investment Funds, where projects are evaluated against scenarios that are not consistent with EU energy and climate targets.[15]

As Table 1 shows, €1.9 billion from the MFF have already been committed to gas projects. For CEF energy, the share of gas projects has been particularly high, with 64% of the total amount committed to so far. While Structural and Cohesion spending has essentially been locked in via the Operational Plans of the member states, the majority of the EFSI and CEF budgets still have to be allocated.

Road and airport infrastructure represent another example of policy misalignment. €32.3 billion have already been committed to high-carbon transport infrastructure – even though passenger transport demand peaked in 2009 and has remained stable since.

[13] Council of the European Union (2016) **EU budget for 2017: Council agrees its position**

[14] UNFCCC (2015) **Paris Agreement**

[15] UNFCCC (2015) **Paris Agreement**

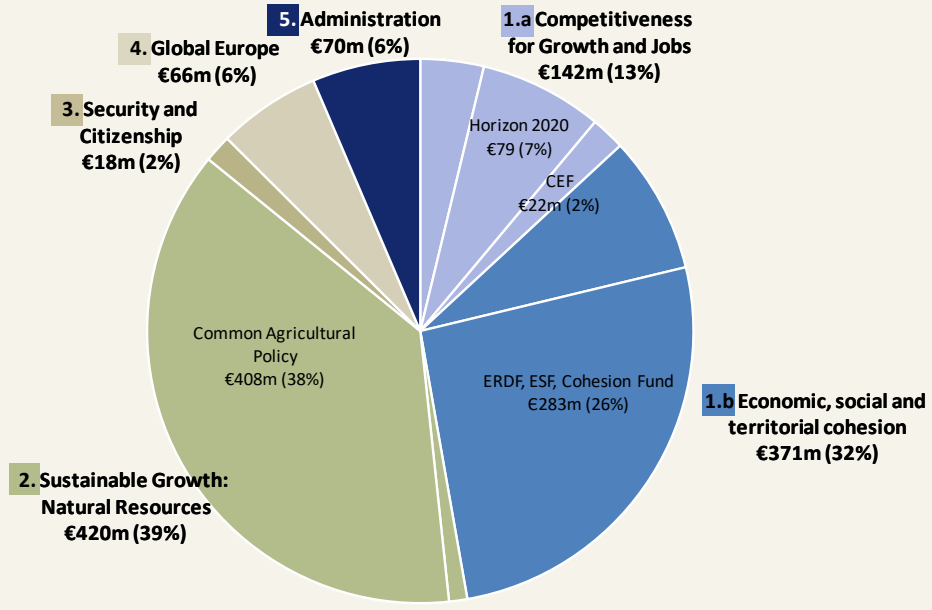
Recap – What constitutes the "EU budget"

The EU's Multiannual Financial Framework (MFF), which amounts to €1.09 trillion for the period 2014-2020, is split into five budget headings which broadly reflect the EU's priorities: Sustainable Growth, Natural Resources, Security and Citizenship, Global Europe, and Administration. These categories consist of very different programmes.

Budget headings 1 and 2 are the most important to the low-carbon transition (Figure 2). Heading 1.a includes both the Horizon 2020 programme (€79 billion), which is a key tool for enabling clean technology research and development, and the Connecting Europe Facility (€22 billion), which is a vehicle to finance cross-border transport, energy and telecommunications infrastructure. Heading 1.b includes the Structural and Cohesion funds (€283 billion), which finance both high-carbon and low-carbon infrastructure – especially in the EU's poorer regions and member states. Heading 2 largely consists of the Common Agricultural Policy (CAP, €408 billion), which has climate and ecological implications through the kind of agriculture and livestock farming it promotes.

The current MFF foresees about €1.09 trillion in expenditure over the 2014-2020 period, which amounts to roughly 1% of EU GDP per year. This might seem small compared to the budgets that the member states have available – Germany's 2015 budget, for instance, amounted to €317 billion, or 10.4% of national GDP. But the importance of the EU budget in steering investment in Europe should not be underestimated. In many critical areas, like infrastructure investment, EU funds act as seed money to facilitate private and public sector funding of projects that would otherwise have been judged as too risky or unattractive.

Figure 1: 2014-2020 MFF by headings and major programmes



Source: ***European Commission***

Putting demand reduction and energy efficiency on an equal footing with supply side options can unlock powerful synergies by reducing energy demand and increasing energy productivity.[16] Current economic appraisals in the energy sector often discard energy efficiency in infrastructure investment decisions. Energy efficiency should be put first to avoid wasteful spending, meaning that all supply side investments involving public money should have to assess whether investing in energy efficiency would be preferable.[17]

Table 1: High-carbon MFF spending in the 2014-2020 period

Type	Programme	Period	MFF spending
Gas infrastructure	Structural and Cohesion Funds	2014-2020	€930m
	CEF	2014-current*	€698m
	EFSI	2014-current	€294m
Total			**€1,922m**
High-carbon transport	Structural and Cohesion Funds	2014-2020	€30,389m
	CEF (excl. Cohesion Fund)	2014-current**	€232m
	EFSI	2014-current	€1,694m
Total			**€32,315m**

*Includes 2014, 2015 and first 2016 call for projects.

**Includes 2014 and 2015 calls for projects.

Sources: *European Commission (**ESIF**, **CEF Energy**, **CEF Transport**), **EIB***

It is extremely difficult to quantify the EU's climate-harmful or counterproductive spending as a whole. By neglecting to report on climate-harmful expenditure, the Commission makes it impossible to assess the EU's net climate spending. As a first step towards phasing out carbon-intensive EU budget expenditure, the Commission should institute a "reverse Rio markers" approach to assess whether projects are entirely (100%) or significantly (40%) harmful to the climate.

A smarter integration of European gas and electricity systems as well as demand-side management, for instance, can realise significant savings in gas infrastructure spending. A recent study has shown that an integrated perspective considering gas, electricity and buildings efficiency together has the potential to reduce gas infrastructure investments by 80% while preserving security of supply.[18]

The EU needs to look closely at the remaining 80% of the budget – otherwise it risks locking member states into fossil-fuel dependency and wasting scarce public money on assets that will ultimately be left stranded. This is especially damaging regarding infrastructure, which typically needs to be long-lived in order to be economic.

[16] UNFCCC (2015) **Paris Agreement**

[17] ECF *et al.* (2016) **Governance for Efficiency First: "Plan, finance and deliver"**

[18] Energy union Choices (2016) **A Perspective on Infrastructure and Energy Security In the Transition**

The EU could make its money go much further by reviewing its spending priorities. Instead of having a budget that pulls in different directions, Europe needs to refocus spending on achieving the future it aims for. Otherwise, the EU either engages in systematic value destruction by financing future stranded assets or undermines its own low-carbon future with potentially devastating consequences for the global fight against climate change.

The EU MFF mid-term review should seek to:

> **Track high-carbon spending in the EU budget, using a similar methodology as for climate-tracking.**

> **Commit to reducing high-carbon spending, aiming to phase it out completely.**

> **Reassess how projects are evaluated to ensure all EU budget spending is fully consistent with EU climate and energy objectives.**

> **Prioritise energy efficiency investments over new energy generation and transmission projects.**

CHAPTER 2
SPENDING PRIORITIES FOR A SMOOTH LOW-CARBON TRANSITION

Refocus the European Fund for Strategic Investments

Europe faces an investment gap, not only in the clean energy field but also in the wider economy. Eight years on from the financial crisis, investment in the EU has yet to return to pre-crisis levels.[19] The EU budget has an important contribution to make to close this gap. But investment not only needs to be scaled up – it needs to be targeted to areas with a significant potential for growth.

The green technology sector currently employs over 1% of the EU workforce and has a turnover of €550 billion.[20] More ambitious energy efficiency programmes alone could create up to 4.2 million additional jobs by 2030, or 2% of the EU workforce.[21] Growing the green economy further is more important than ever, with Europe still reeling from an economic crisis and widespread youth unemployment.

To address the investment gap, the Commission proposed an 'Investment Plan for Europe' in 2014. The Investment plan, together with the newly-created European Fund for Strategic Investment (EFSI), is central to the economic strategy of the Commission. The Investment Plan "focuses on removing obstacles to investment, providing visibility and technical assistance to investment projects and making smarter use of new and existing financial resources".22 As part of the Investment Plan, the EFSI seeks to mobilise investments of at least €315 billion by 2018, through providing a risk-sharing instrument to invest in new, riskier, projects that would not otherwise go forward.

So far, the EFSI has achieved 32% of its goal of mobilising €315 billion investment: €21 billion of EFSI backing will trigger €100 billion in European investment from public and private partners. Energy and transport are the biggest receivers to date with €6.6 billion of the committed €10.7 billion as of August 2016, of which €4.3 billion will go towards low-carbon investments like renewables, smart-metering and rail infrastructure (Figure 2). The advisory hub has been crucial in delivering these investments by providing technical assistance to project stakeholders, from projects developers to investors and public managing authorities. The hub helped regions and

[19] DG ECFIN (2015) **Why are investment levels in the EU so weak?**

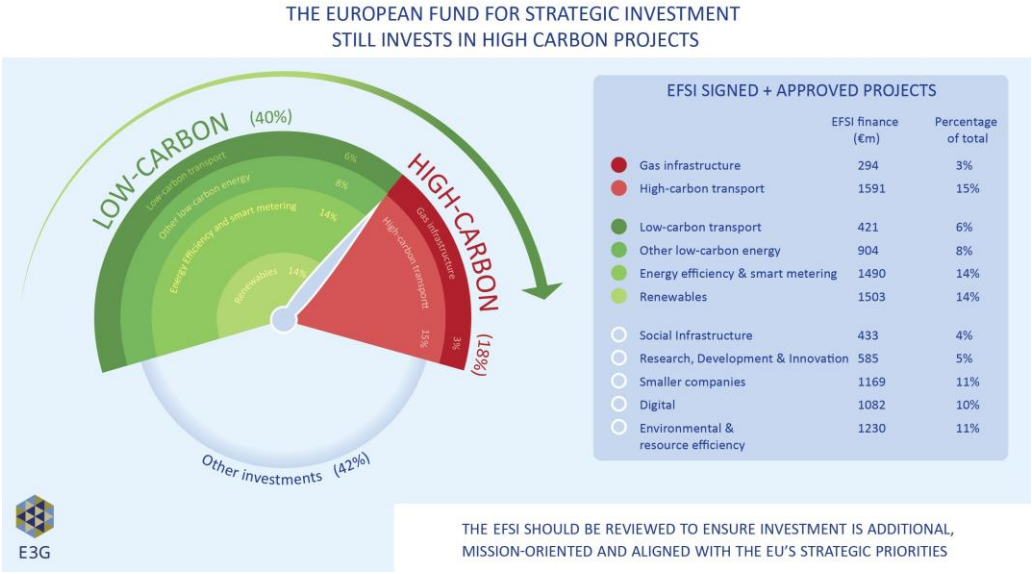
[20] Ecorys (2012) **The number of jobs dependent on the environment and resource efficiency improvements**

[21] Cambridge Econometrics (2015) **Assessing the Employment and Social Impact of Energy Efficiency**

[22] European Commission (2016) **Investment Plan for Europe**

cities to bring forward scalable projects, especially in those Member States with less experience and capacity.

Figure 2: Distribution of EFSI funding as of August 2016 (signed and approved projects)



Source: EIB, E3G

The EFSI however does not go far enough to deliver investments which are of high economic value to all European citizens and businesses. For example, with only one project selected in each category so far, additional funding is sorely needed for residential building efficiency and electricity networks.

To make matters worse, the EFSI has also funded road and airport projects with €1.6 billion and gas transmission infrastructure projects with €294 million. These high-carbon investments run counter to the EU's climate and energy goals. In particular, the gas infrastructure projects are highly likely to end up as 'stranded assets'[23]. These kinds of projects should not be supported out of the EU budget at the time when the EU is phasing out subsidies to fossil fuels.

In addition, the EIB still largely fails to invest in projects that are riskier than its usual pipeline. Analysis by Bruegel suggests that almost all EFSI projects could have been financed by the EIB without backing from EFSI.24 The ambitious target of delivering €350 billion of investment under the fund should not distract the EIB from focusing on truly additional projects.

[23] E3G (2015) **More security, lower cost**

[24] Bruegel (2016) **Assessing the Juncker plan after one year**

The Commission is expected to launch an "EFSI 2.0" to expand the fund beyond the initial three years period. This revision should also address the flaws of EFSI 1.0 and make sure the funds provide the maximum added value.

As the Commission proposed its Investment Plan while the current MFF was already well under way, the Council and the Parliament reallocated some funding from other parts of the budget to fund the EU guarantee behind EFSI. The main funding reductions came from Horizon 2020, the Connecting Europe Facility and unallocated margins, which are now all smaller than foreseen in the original agreement prevailing at the beginning of the MFF.

While the EFSI will likely replace many of the investments that would otherwise have occurred under these programmes, a recent evaluation of Horizon 2020 states that innovation funding will most likely be subject to "damaging cuts" as a result of the reallocation.[25] Drawing on the unallocated margins is not without problems either as they represent a main source of flexibility in the EU budget. Earmarking €3 billion from unallocated MFF margins means the EU can't draw on those funds to respond to emergencies such as the refugee crisis.

The European Parliament has already expressed its will to fully offset the EFSI-related cut affecting Horizon 2020 and the Connecting Europe Facility.[26] The focus of the EFSI 2.0 should continue to be on financing sustainable projects. All projects should contribute to Europe's low carbon transition. The EFSI needs to bring new investment into Europe's energy transition rather than pushing more funding into high-carbon infrastructure that could ultimately become stranded as the EU meets its climate and energy goals.

The parallel discussions about the MFF and the EFSI should focus on implementing a series of reforms needed to make the best use of public money and foster investments in Europe. This means:

- **Increasing the resources available for the advisory hub to help building a pipeline of adequate projects to be financed.**
- **Focusing on projects with the highest added value, i.e. projects that are scalable, productive, truly additional and climate resilient.[27]**
- **Prioritising areas where the market is not yet delivering its full potential, for instance infrastructure where long term capital is required and energy efficiency where projects need scale and resources towards aggregation vehicles could help overcome financing challenges.**

[25] European Parliament - DG Internal policies (2016) **Assessment of the Horizon 2020 Programme**

[26] European Parliament **Preparation of the post-electoral revision of the MFF 2014-2020: Parliament's input ahead of the Commission's proposal**

[27] E3G (2016) **Europe needs a stronger investment plan for the Energy Union**

Deliver a socially fair low-carbon transition

It is a long-standing criticism of the EU that it has succeeded in pushing for increased market liberalisation without achieving a corresponding integration of social policy and welfare. The structural adjustment programmes imposed by the EU on creditor member states during the debt crisis have deepened the perception of a Europe that does not care about the social impact of its economic policies.

For the EU's approach on smart and sustainable growth to succeed, the social impact of the low-carbon transition must be taken into account. While green growth is necessary to maintain Europe's industrial strength and will create countless jobs to boot, some sectors will lose out as a result of the low-carbon transition. Climate policy poses difficult – and in some cases existential – challenges to emissions-intensive sectors like coal, steel, chemicals or paper.

Coal mining and coal-based power generation in particular are incompatible with the near-zero-emissions economy that the EU is aiming for by 2050. All the remaining 277,000 jobs in the coal industry will therefore have to disappear in the medium term.[28] The impact of this is amplified as these jobs are highly concentrated in regions that typically offer few employment opportunities in other sectors.

It is very worrying in this context that the 2017 budget proposal of the Council is planning to cut spending for the ESIF by 24% and the Globalisation Adjustment Fund by 17%.[29] This will restrict the money available for measures to cushion the impact of the low-carbon transition. In the same vein, the Commission's recently published communication on a European Pillar of Social Rights was initially expected to focus on ensuring a socially fair low-carbon transition – but the final version omits any reference to the issue.[30] This is regrettable as the concerns of the affected workers and regions should be taken seriously.

Fears over job losses and regional economic decline are the most important reasons for many unions and local politicians to oppose climate policy progress. In countries where emissions-intensive sectors are concentrated, like much of Central and Eastern Europe, there are clear incentives to obstruct the long term goal of a low-carbon economy in Europe.

Europe's ability to manage its reduction in the use of fossil fuels and high-carbon products in a way that is socially fair and just to its workers will ultimately determine the success of the low-carbon transition. Creating a strong and EU-wide Just Transition framework with budgetary backing would go a long way towards addressing these challenges. The EU budget, however, does not treat this as a priority. There is no dedicated funding mechanism for ensuring a socially fair transition.

[28] EUROCOAL (2015) **EUROCOAL Statistics**

[29] Euractiv (2016) **EU budget for 2017: Cohesion down, security up**

[30] European Commission (2016) **Consultation on the European Pillar of Social Rights**

Current eligibility criteria for the European Structural and Investment Funds do not take the economic impacts of the low-carbon transition into account, either.

The EU budget can play a key role in ensuring a socially-just transition, by:

- **Treating measures to address the social impacts of the low-carbon transition as a budgetary priority.**
- **Instituting a Just Transition Fund, as long demanded by the European Trade Union Confederation (ETUC),[31] which should:**
  - **Draw resources both from the EU budget as well as the sale of ETS emissions certificates.**
  - **Finance investments in alternative economic sectors, job training and other employment services as well as health and retirement security for laid-off high-carbon workers.**

[31] European Trade Unions Confederation (2015) **Position on the structural reform of the EU Emissions Trading System**

CHAPTER 3
PRECONDITIONS FOR EFFECTIVE EU SPENDING

Align Energy Union governance with the budgetary process

The European Commission and the national governments are developing the template of the future National Energy and Climate Plans with the aim of raising investor confidence. The plans will integrate national objectives for greenhouse gas emissions, energy efficiency and renewable energy. Member states will be required to detail how they intend to reach these objectives and what policies they plan to implement. Alongside policies, the plans should also include infrastructure deployment and capital raising plans. This integrated planning would avoid stranded assets by putting infrastructure planning in a long-term perspective (up to 2050) and by taking into account the effect of energy efficiency policies on energy demand.

The capital raising plan will help building investor confidence by increasing the predictability and the transparency of the planning process. During the process of drafting these capital raising plans, the different ministries will agree on four main questions: what needs to be financed? Who will finance it? How will it be financed? How to meet the objectives? These plans have the potential to represent a robust project pipeline, which can help provide much needed certainty for investors.

Europe can draw from the rest of the world as countries elsewhere are developing similar plans. Chile and Mexico have devised capital raising plans to help them meet their Nationally Determined Contributions submitted to the UNFCCC. These plans include "a shared understanding of what needs to be financed, over what timeline, where the financing should come from and how it can be delivered"[32]. Having similar infrastructure and capital raising planning in the EU will help attract investment and send a signal to investors about the EU's and the national governments' commitment to deliver this infrastructure.

The financing strategy underpinning the plans will contribute to increased investment in Europe. These plans should lay out the kind of money required to deploy the infrastructure needed to reach the national climate and energy targets. Public money will not deliver all the infrastructure needed. Hence the focus should be on how European and national public finance can be deployed alongside policy initiatives to maximise the 'crowding-in' of private capital to deliver climate compatible development aims.

[32] E3G (2016) **Considerations for a climate finance strategy in Chile**

The EFSI is a step in the right direction in this regard but the EU needs to continue diversifying the type of money available. The infrastructure project pipeline will help the EU design its public funding stream to directly support or help leveraging private finance depending on the type of finance needed. This bespoke approach will maximise the consumption of EU public funds and will be the most useful to the delivery of the 2030 and the 2050 targets.

The upcoming discussions on the budget should keep front and centre the 2030 and 2050 climate and energy objectives. The governance system of the Energy Union provides the opportunity to increase investors' confidence, leverage private investments and improve the absorption rate of European funds provided member states develop capital raising plans.

Ensure a flexible and responsive MFF

The EU is currently operating with a budget that reflects the priorities of member state governments in 2013, filtered through a structure of calcified political horse-trades and path dependencies. It is already out of step with current priorities. Since the beginning of the current MFF in 2014, several unexpected developments have wreaked havoc with the EU's budgetary planning, including the migration and refugee crisis, internal security issues, the crisis in agriculture, compensation of EU farmers affected by the Russian trade embargo. This has amply demonstrated that the MFF process is not suited to react flexibly to changing circumstances.

As a result, the EU budget has essentially been pushed to its limits. After exhausting all available margins in the budget heading, unprecedented recourse had to be made to the EU's flexibility instruments. Despite this, the EU had to set up several extra-budgetary instruments such as EU trust funds and the Refuge Facility for Turkey, which are completely outside the European Parliament's control.

Apart from unforeseen events, the MFF process does not make it easy for a newly elected College of Commissioners to change course. When the activist Juncker Commission took office in 2014, for instance, they could only set new spending priorities and institute the European Fund for Strategic Investments (EFSI) by reallocating money from other funds. The EFSI uses €16 billion from the EU budget to guarantee investments, €8 billion of which have already been appropriated. This was accomplished by reducing the budgets of the Connecting Europe Facility (CEF) and Horizon 2020 by €2.8 billion and €2.2 billion, respectively, as well as taking €3 billion from unallocated MFF margins.[33]

As an instrument, the EFSI is very welcome as it mobilises much needed investment in the European economy. However, the ad-hoc rearranging of the MFF that was necessary to make it work has caused problems. Cutting the CEF and Horizon 2020

[33] European Parliamentary Research Service (2015) **Briefing – How the EU budget is spent**

budgets potentially weakens the EU's contribution to large-scale communications and energy infrastructure projects as well as clean technology innovation. While the EFSI will likely replace some of the investments that would otherwise have occurred under these programmes, a recent evaluation of Horizon 2020 states that innovation funding will most likely be subject to "damaging cuts" as a result of the reallocation.[34] Drawing on the unallocated margins is not without problems either as they represent a main source of flexibility in the EU budget. Earmarking €3 billion from unallocated MFF margins means the EU can't draw on those funds to respond to the refugee crisis.

These difficulties can be avoided in future if the EU's budgetary cycle is brought in line with its political cycle. This would eliminate the need for a new College of Commissioners to operate within an MFF negotiated under the auspices of their predecessors. Strengthening existing flexibility mechanisms within the budget would furthermore strengthen the EU's capacity to react to unforeseen circumstances.

In the climate and energy field, the Paris Agreement means that the EU – along with other signatories to the agreement – will need to review its climate commitments every five years, with a view to ratcheting ambition upwards. Within the EU, member states will produce National Energy and Climate Plans to 2030 by 2019, with a review set for 2024. The MFF is a key tool for delivering EU climate aims and for enabling member states to deliver their own energy and climate plans. As such, alignment between the MFF process and the EU's key decision-making moments on energy and climate will be needed.

The MFF review should highlight the importance of:

> **Replacing the current 7-year MFF cycle with a 5-year cycle aligned with the political cycle of EU institutions.**

> **Instituting a formal process whereby budget allocations can be renegotiated, including within and between annual ceilings.**

> **Increasing the allocation to flexibility mechanisms, in particular the general-purpose Contingency Margin. Alternatively, introduce a crisis reserve with substantial budgetary means (e.g. at least €10 billion) as called for by the European Parliament and in a recent report for the High-Level Group on Own Resources.[35]**

[34] EPRS (2016) **Assessment of Horizon 2020 programme**

[35] Jorge Núñez Ferrer *et al* (2016) **Study on the potential and limitations of reforming the financing of the EU budget**