Bringing Paris into the future MFF:

how to maximise the benefits of EU funding for the achievement of EU climate objectives

Integrating the 2021-2027 MFF and the new 2030 energy and climate target governance

Version 1.1 –July 9, 2018 – by Matthias Duwe, Ecologic Institute (matthias.duwe@ecologic.eu)

Key Insights

⇒ **Transformative financing with EU support?** The adoption of the Paris Agreement has started to create a shift in climate and energy policy thinking, away from incremental change to long-term transformation. Already, reaching the EU's 2030 targets requires significant additional investment – which will also create economic benefits. Public money has an important role to play in this regard and Member States can and should make use of the support from the EU budget.

⇒ **An opportunity too good to miss!** The MFF 2021-2027 process and the implementation of the new Energy Union governance system for 2030 climate and energy targets run in parallel – and are already set up to interact with one another. Two open windows for interaction:

a. 2018-2020: EU budget programming & National Energy and Climate Plans drafting

b. 2024-2025: mid-term review of the EU budget & Paris Agreement cycle (EU target review).

⇒ **A budget that could boost climate action…** The Commission's EU budget proposal for 2021 - 2027 sticks to the current budget structure, but contains innovations to enhance overall effectiveness. It foresees an increase in climate spending, but its impact is in doubt, due to a lax system for attribution and monitoring. However, the increased visibility of climate and some concrete improvements (exclusion of fossil fuels from ERDF scope, strategic CAP plans, closer performance monitoring) could become building blocks for additional national action.

⇒ **How to create an effective connection** between the 2030 climate plans and the MFF:

1. **ALIGNMENT OF STRATEGIES**: The link exists, but needs improvement so that national investment needs can be matched with EU funding and access to private finance.
2. **INCENTIVES FOR HIGHER AMBITION**: The EU budet knows ex ante conditionalities well and the proposal foresees a small climate action component for allocation. Higher ambition for national climate and energy targets should result in more funding/better conditions.
3. **REWARD PERFORMANCE**: The MFF penalises underperformance – but knows few incentives for doing better than expected. New options need to be created for this purpose, using a reserve. As a minimum, incentives to avoid policy roll-back should be generated.

In sum: the 2021-2027 EU budget could play a role in unlocking higher climate ambition and facilitating good performance, creating the foundation for a coordinated transformation in Europe.

Background: objectives of this paper

This paper was prepared to serve as a stimulus for discussions to explore the potential linkages between the future architecture and spending priorities of the post-2020 EU budget and the governance system for the mid- and long-term climate and energy objectives. It provides essential background and identifies key questions for discussion about the possible nature of a connection of the 2021-2027 Multi-Annual Financial Framework (MFF) and the new Integrated National Energy and Climate Plans (NECPs) (under the Regulation for the Governance of the Energy Union).[1]

Context: Implementing the Paris Agreement in Europe

Transformational change

The EU and its Member States consider themselves champions of the Paris Agreement (PA) and have already made significant steps in preparing for the implementation of the EU's commitments captured in its so-called "nationally determined contribution" (NDC) to the PA, which is a reduction in greenhouse gases (GHGs) by 40% from 1990 levels by 2030. The Paris Agreement contains specific long-term climate objectives, notably the limitation to keeping the warming to "well below 2°C above pre-industrial levels" with "efforts to limit the temperature increase to 1.5°C" (PA Article 2.a). It translates this into a steep trajectory with rapid emissions reductions towards a gradual phase-out, with **a global ambition of creating a state of net zero additional emissions** after 2050 ("a balance between (…) emissions (…) and removals (…) in the second half of the century"" (PA Article 4.1)).[2] An industrialised country body such as the EU, with great historical responsibility and more financial means, would arguably need get to net zero earlier.

The message from the Paris Agreements is unequivocal: climate policy is no longer about marginal changes and incremental reductions, but about fundamental, structural change, a **transformation of our economies**. Due to the magnitude of the change required, and with an ever-shrinking remaining carbon budget, the transformation does need to start right away (and is already underway to some extent, e.g. in the power sector), even if there are not simple, ready-made answers on how to do it for every sector. Figuring out how to decarbonise is a partially exploratory process - but with a very clear long-term direction. The adoption of the Paris Agreement thus implies changes for the way the EU thinks about and organises its climate policy.

Need for significant additional investments

A key challenge in realising the long-term transformation is that **financial flows** need to be directed away from emission intensive activities and into clean ones. Moreover, additional investments are required now. However, these could help prevent costs for climate damages further down the line.

[1] The Author gratefully acknowledges the support of the European Climate Foundation for the work on this paper. This work has benefited from substantial prior thinking and analysis generated by other organisations, notably E3G & Climate Action Network (CAN) Europe and comments provided by individual colleagues – as well as the collaboration with analysts at the European Policy Centre (EPC).
[2] Bodle, Donat, & Duwe. (2016) "The Paris Agreement: Rebooting Climate Cooperation · The Paris Agreement: Analysis, Assessment and Outlook", Carbon & Climate Law Review, Volume 10, Issue 1 (2016), pp. 5 - 22

According to calculations by the European Commission published in 2016, achieving the trio of targets on the table then (-40%GHGs, 27% RE, 30% EE) required less than 20% on top of the investment needs without the climate and energy targets[3]. For the higher targets now adopted, this additional need will increase accordingly. Insofar as this is money invested in the European economy it comes with significant potential for additional jobs and a range of other co-benefits. At the same time, ensuring access to the necessary financing and channelling the investments into transformative investments is a major task – one in which there is a specific role for public funding (e.g. from the EU budget) to fill gaps and to attract private finance.

The Paris Agreement highlights this issue prominently, at the same level as the temperature goals in Article 2 of the treaty, and puts it at the heart of its mission to make "financial flows consistent with a pathway towards low greenhouse gas emissions and climate resilient development" (PA, Article 2.1.c). As Parties to the treaty, this is an obligation that the EU and its Member States need to take on board, in addition to fulfilling its NDC – but also as a means of financing the necessary emissions reduction policies and actions.

Opportunity for alignment and mutual benefit

Several relevant policy processes are currently underway in parallel, which create the opportunity to think them together, and create targeted synergies:

A. At the UN level, the Paris dimension, the so-called Talanoa Dialogue process is underway in 2018, pre-cursor to the "global stocktakes" that are meant to happen every five years from 2023 onwards. It is meant to point out gaps in the collective ambition of the pledged actions and induce reviews of the current NDCs in 2019, with final submission in 2020. This by definition needs to trigger **a conversation in the EU about increasing its overall ambition**. With higher energy targets just decided in June, an increase in the EU GHG reduction objective is already being addressed. While individual Member States had already called for such an increase (e.g. 55% Netherland and Sweden) European Commissioner Miguel Arias Cañete voiced publicly just days after the deal on the Clean Energy Package that a 45% reduction was now in order.
B. A new system of governance for the 2030 energy and climate targets of the EU has just been adopted, with so-called integrated National Energy and Climate Plans (NECPs) as a comprehensive planning tool, embedding **national contributions to the EU objectives in a coherent overall strategy,** with details on policies for implementation. The plans need to be submitted in draft form by the end of 2018 and finalised by the end of 2019.[4]
C. On May 2, 2018, the European Commission published its **proposal for the next MFF** (2021-2027), followed by specific legislative proposals on the individual funding instruments. The Commission declares the proposal to be more streamlined and

[3] 178 billion Euro annually in additional investment in the years 2021 to 2030 on top of 944 bn € per annum required anyway, as per EC (2016): Impact assessment - Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2012/27/EU on Energy Efficiency. SWD(2016) 405 final.
[4] Temporary consolidated version of the Regulation on the Governance of the Energy Union (not available for download at time of writing)

performance oriented. The **climate dimension features more prominently in the overall structure of the budget** compared to the existing system, with an increase to 25% from 20% for climate across the budget and several other new references – but shortcomings with the current accounting (such as a distinction between mitigation and adaptation, or overestimations) are not fully addressed.[5]

The parallel timing of the processes creates a window of opportunity for alignment of the respective structures and contents and the creation of targeted interlinkages. To explore the potential for these connections, the following sections provide more background on the new system for climate and energy governance and the post-2020 MFF – and then spell out the principled interactions and key questions to guide further discussion on these linkages.

Background 1: A governance system to implement the Paris Agreement

Since 2015, the EU has been making steady progress in putting together the necessary legislation to implement the Paris Agreement and organise the implementation of its 2030 climate and energy objectives (which include its NDC under Paris). It has revised key pieces of legislation, such as the EU Emissions Trading System (ETS) Directive, the Climate Action Regulation on non-ETS targets and Directives on Renewable Energy and Energy Efficiency and adopted a new Regulation for the Governance of the Energy Union (replacing the Monitoring Mechanism Regulation). Together with a series of other energy related instruments, the latter three are key parts of the so-called Clean Energy package. Political agreement on the content of said directives and the Governance Regulation was reached among the EU institutions in Trilogue negotiations in mid-June 2018 after 18 months of analysing and refining the original Commission proposals in the European Parliament and in the respective Council formations. The new legislative framework brings with it a number of changes from the system in place currently for 2020. In the context of this paper, the most relevant elements are:

- The national renewable energy targets will no longer be directly binding, but remain indicative and are now essentially **pledged contributions**. This was already the case for the economy-wide efficiency targets for 2020[6]. At EU level, however, the collective renewables target is meant to be binding – which creates an inherent tension - and the **risk of gaps** between the sum of the pledges and the EU targets. The European Commission is meant to monitor and address any ambition or implementation gaps.
- A range of existing planning requirements have been integrated into new, overarching "**integrational national energy and climate plans**" (NECPs), which should contain all relevant national objectives and provide a comprehensive and coherent roadmap on how to reach them (incl. policies and financing, across sectors). These will also the basis for

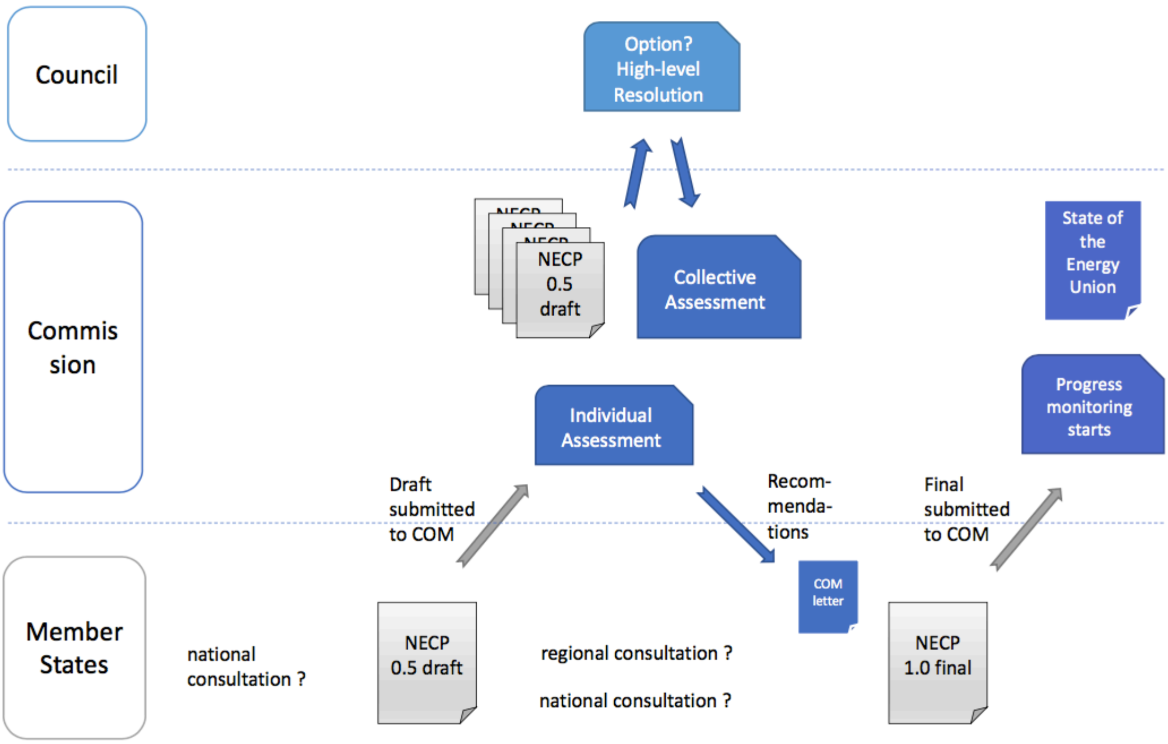
[5] European Court of Auditors (2016) "Special Report. Spending at least one euro in every five from the EU budget on climate action: ambitious work underway, but at serious risk of falling short"; Ricardo/IEEP/Trinomics (2017) "Climate mainstreaming in the EU Budget: preparing for the next MFF. Final report"
[6] However, there is a binding obligation for Member States in the Energy Efficiency Directive, which requires 0.8% annual energy savings until 2030, with a view to 2050.

progress monitoring. While the NECPs streamline existing obligations, their integrated approach will require an upfront investment of different policy areas by Member States - and there is not much time left for first drafts, due by December 2018.

- The time dimension has been expanded clearly **beyond 2030**, with an obligation to produce 2050 long-term strategies (LTS) by early 2020. Moreover, the NECPs need to look beyond 2030 in many ways, and have to be consistent with the 2050 strategies. In addition, the European Council gave a mandate to the European Commission to produce a **proposal for a 2050 strategy** for the Union as early as the first quarter of 2019.[7] This request has been taken up and specified further in the Governance Regulation (Article 14). All of these long-term elements are a representation of the growing understanding that the EU climate policy under the Paris Agreement needs to be transformational, not incremental.

The NECPs need to follow a mandatory common template that is spelled out in an Annex to the Governance Regulation, allowing potentially for a high degree of comparability between countries. Included among the many data points the plans will provide should also be information on financial measures being used, including specifically projected use of EU funds.

Figure 1: Energy Union Governance - drafting and approval process for NECPs



Source: own visualisation © Ecologic Institute 2018

While responsibility for drafting and implementation of the plans lies with individual Member States, they are requested to consult with neighbouring countries in regional consultations. The European Commission acts as guardian of the legislative requirements (compliance check) and, more

[7] Council Conclusions, 22 March 2018 - https://www.consilium.europa.eu/media/33457/22-euco-final-conclusions-en.pdf

importantly, also has to undertake an assessment of the sum of the national contributions to the renewables and efficiency targets of the Union (see also Figure 1 above for a representation of the process and the main interactions involved). The Commission may issue recommendations to Member States, both on draft plans as well as on any shortcomings in their implementation. The Council of the European Union and the Parliament could be engaged in a supervisory role (Article 29 bis) – and for the former this could include a role in the resolution of conflicts over ambition or progress gaps (it has a similar involvement in the European Semester).

While this new system brings with it several innovations, similar approaches have previously been used in renewables and energy efficiency (with respective national action plans), and thus some prior experience exists. The most challenging innovation is the conflict between binding EU targets and indicative national pledges – and one that consumed significant attention in the negotiations on the Governance Regulation. A crucial consideration in this context was and is how to incentivise if not **inspire higher ambition in the national plans**.

In addition, the new sets of targets will require more policy action at national level for all priority areas – they will require more effort and targeted measures, including financing. For 2020, most Member States are achieving if not outperforming their climate targets and while individual countries may be behind on energy targets, the EU level objectives (20% - 20% -20%) are all currently on track.[8] The further the targets move from incremental to transformational change, **collaborative solutions are required** – with regional if not EU level coordination and support as enabling conditions.

An additional element in this regard is Europe's **energy and mobility infrastructure** (storage, transmission lines, grids, railways and electrification), which requires also a coordinated approach, and additional financing – and is part of the elements that should be in the NECPs. Especially for high penetration of renewable electricity generation, the current, ageing energy infrastructure needs to be adapted and made fit for purpose – it otherwise runs the risk of becoming a major stumbling block to decarbonisation. At the same time, investing in further high emission infrastructure (highways, pipelines, etc.) could equally be detrimental to a successful low carbon transition. Infrastructure projects are already a focus in previous Cohesion Policy spending and the future MFF will thus have an impact on the kind of infrastructure that will be built.

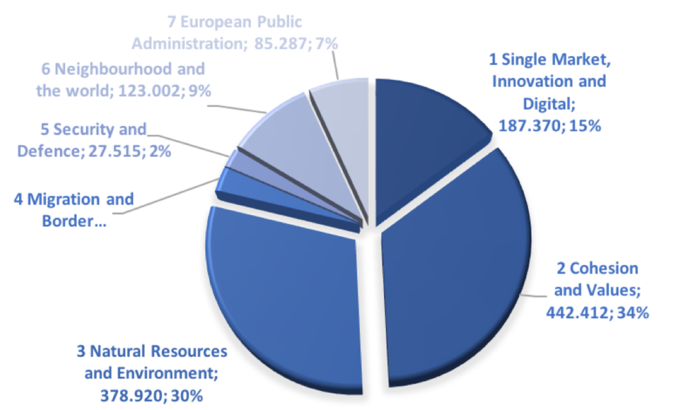
In sum, Member States need the support – and the 2021-2027 MFF could play a role in both unlocking higher ambition and facilitating good performance, and creating the foundations for a coordinated transformation in Europe.

[8] EEA (2017) Trends and projections 2017. Tracking progress towards Europe's climate and energy targets. https://www.eea.europa.eu/themes/climate/trends-and-projections-in-europe/trends-and-projections-in-europe-2017

Background 2: The post-2020 EU budget and its climate dimension

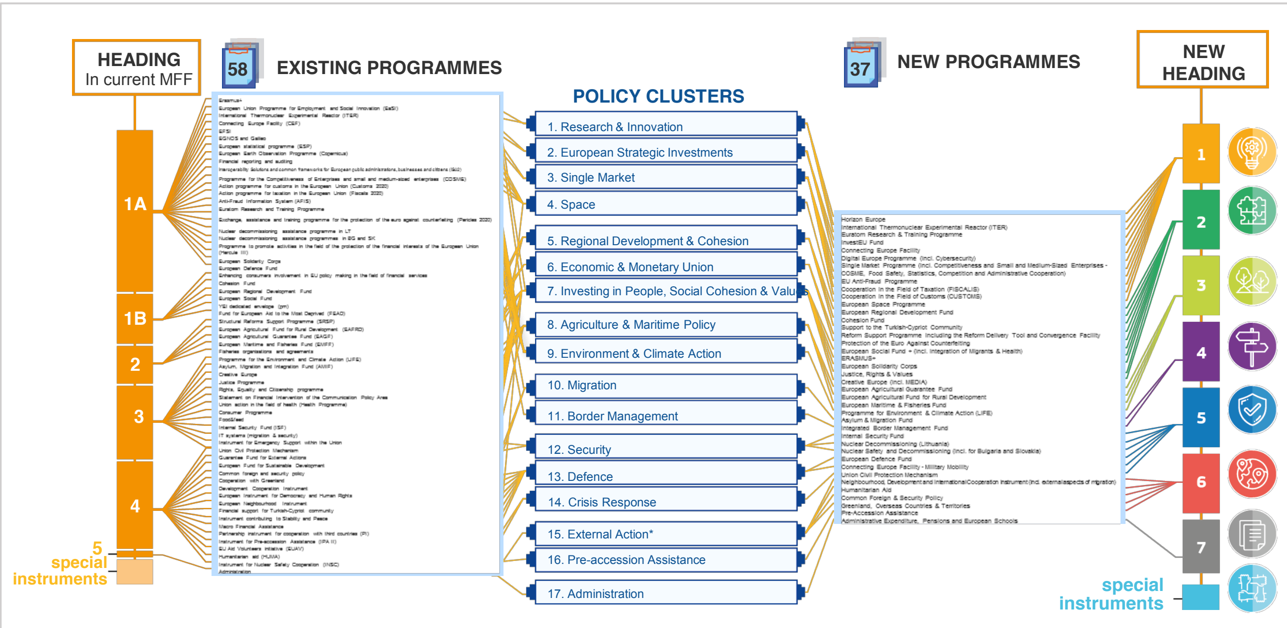
At the same time as the Governance Regulation was being negotiated, the European Commission published its proposals for the future of the next Multiannual Financial Framework (MFF) (for the period 2021-2027), including draft legislation for specific financing instruments. The new proposed structure for the MFF post-2020 introduces a number of changes from the current system, but also leaves the essentials unchanged. The number of programmes is reduced and reorganised under seven headings instead of five, for example (see Figure 3 below), but Cohesion Policy and the Common Agricultural Policy (CAP) remain the two biggest spending points (with minor reductions). Overall, the Commission emphasises the intention to link the EU budget to the EU's political priorities and its collective ambition – and, furthermore, wants to strengthen the importance of performance. Together, these statements and some of the specific changes create an **opening for a closer linkage to the 2030 and long-term climate policy** governance.

Figure 2 Indicative shares of seven main headings under the proposed MFF for 2021-2027 (values in million €)



Source: Commission data, own visualisation

Figure 3: Commission presentation of the changed structure, with a third fewer programmes after streamlining



Source: European Commission MMF slide deck "EU Budget for the Future" – EPC Workshop May 17th, 2018

The size of the proposed budget is €1.28 trillion (at current prices) over the seven years (just over €180 bn per annum), a slight increase over 2014-2020. In the context of the need to redirect financial flows and generate significant additional investment to kick off the transformation to a net zero economy, the MFF clearly can and needs to be making a contribution.

Climate mainstreaming to be increased slightly

As one of several innovations to previous EU budgets, the current MFF (2014-2020) already includes a commitment to spend at least 20% of all funding on climate action (both mitigation and adaptation) (again, largely not "additional" necessarily). The latest assessment shows the target being missed, with a forecast of 19.3% of climate related spending[9] – but the gap could still be filled. However, there are shortcomings in the system, with several inconsistencies in the accounting and the climate mainstreaming not happening thoroughly – plus financing going into actions with potential negative effects (such as higher emissions).[10]

For 2021-2027 the Commission proposes to increase the climate mainstreaming target to 25%, but without breaking this down into binding shares for key spending instruments – although several of them have indicative or aspirational ones.[11] Additional references to climate action are being made in several places, including the Cohesion Policy objectives (more detail below). The Commission even proposes to link some of the revenue stream for the budget to a climate policy measure, by taking 20% of the money generated via auctioning allowances under the EU ETS for its "own resources" to fund MFF expenditure. However, as Member States already use the vast majority of the revenues for climate related purposes (according to their own reporting)[12], this proposal could end up reducing financing available for climate action.

Specific changes from the previous MFF

Other relevant and noteworthy points from the proposal include, among others, the following:

The proposals assert an overall **stronger focus on performance** (the MFF communication alone has 25 instances of the word) and there is an **emphasis on strategic planning** across programmes. The previously existing performance reserve is being discontinued – but a new Union reserve is created instead.

In **Cohesion Policy**, the main structure stays the same (Partnership Agreements and Operational Programmes), but the number of objectives is more than halved (from 11 to 5). The proposal foresees higher national co-financing rates (= more to be paid by MS), but allows the flexibility for Member States to use parts of the funding to access support from InvestEU (a new investment fund to replace the existing European Fund for Strategic Investments (EFSI) and other centrally managed Financial Instruments) to leverage additional private financing.

[9] European Commission (2018): Draft General Budget of the European Union for the financial year 2019.
[10] European Court of Auditors (2016); Ricardo/IEEP/Trinomics (2017) – see previous footnotes
[11] A related binding element is the 'thematic concentration' in Cohesion Policy, see more below.
[12] Velten, Duwe, Zelljadt (2016): Smart Cash for the Climate: Maximising Auctioning Revenues from the EU Emissions Trading System. An analysis of current reporting by Member States and options for improvement. Ecologic Institute: Berlin.

The proposal foresees fewer enabling conditions (previously known as 'ex-ante conditionalities') but promises closer monitoring. However, the conditions still focus essentially on Member States having complied with EU acquis and not on qualitative elements. The Commission proposes Annual Performance Reviews for each programme and an annual "structured policy dialogue" with the Commission.

Moreover, the Commission envisages a **stronger link with the European Semester** in Cohesion Policy. Country Specific Recommendations (CSRs) stemming from the Semester (and indeed those from the NECP process) [13] should be taken into account for the Partnership Agreements (Article 9 CPR) and Operational Programmes (Article 18 CPR) and inform the mid-term review. The CSRs, together with additional reform guidance should create "a clear roadmap for investment in reforms that hold the key to a prosperous future" (Communication, p 9). The programming is meant to happen initially only for the first five years, with the mid-term review to inform the last two years.

In the **Common Agricultural Policy**, the essential two-pillar structure remains the same (European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD)). Previously different sets of conditions (cross-compliance and greening) are now integrated and renamed as "enhanced conditionality". The Commission asserts that its proposals shifts the system to a stronger "result-oriented policy to deliver on common objectives".

An innovation is the proposal that Member States will need to produce **Strategic Plans for CAP expenditure**, showing how they will use the funding to meet their specific needs (in relation to the overall objectives). They will, however, be given more flexibility in allocating funding, which could lead to a weakening of the provisions to enhance e.g. environmental ambition.[14]

Climate related elements of the MFF proposal

There are a number of individual elements in the proposals that specifically relate to climate, some of which have already been noted. The increase in the mainstreaming target represents an additional €15 bn per annum (going from around €31 bn to €45 bn in current prices), which is a step towards providing more of the additional financing required for the 2030 targets. However, several stakeholder groups and individual political leaders (such as French President Macron) had asked for a higher share being dedicated in this way – and questions remain over the validity of the marker system for tracking what counts towards the mainstreaming target.

The increase in attention to climate is, however, visible in the set-up of some of the individual instruments, including initial connections to the Governance Regulation and the NECPs.

[13] CPR art. 2 (1) 'relevant country specific recommendations' mean Council recommendations adopted in accordance with Article 121(2) and Article 148(4) of the TFEU relating to structural challenges which it is appropriate to address through multiannual investments that fall within the scope of the Funds as set out in Fund-specific Regulations, and relevant recommendations adopted in accordance with Article [XX] of Regulation (EU) No [number of the new Energy Union Governance Regulation] of the European Parliament and of the Council

[14] Matthews (2018) The Article 92 commitment to increased ambition with regard to environmental- and climate-related objectives. Available online at https://bit.ly/2KpZg7h - accessed July 9, 2018

Cohesion Policy:

- **More attention to low-carbon:** The second policy objective (PO 2) for the Cohesion Policy (out of now only 5) is meant to be "A greener carbon free Europe: clean and fair energy transition" – and three of the other make reference to climate change or sustainability (Article 2 ERDF/CF Regulation). [15] Moreover, a thematic concentration of the expenditure on PO 2 under the ERDF (Article 3 – ERDF/CF Regulation) requires Member States below EU average of gross national income ratio (groups 2 and 3) to spend at least 30% on activities listed under PO 2 (see Annex for list of activity codes for PO 2). This cannot, however, be equated to a 30% binding contribution to the climate mainstreaming target – as not all activities under PO 2 are climate related.
- **Fossil fuels excluded?** Article 6 of the proposed ERDF/CF Regulation explicitly introduces items that are excluded from the scope of the funds (not a feature of the existing Regulation), and lists "(h) investment related to production, processing, distribution, storage or combustion of fossil fuels" (except for gasification of transport) as not eligible for funding. Individual "intervention fields", however, suggest some remaining fossil fuel connection (e.g. code 034 "High efficiency co-generation, district heating and cooling").
- **Reduction effort reward**: Climate is even a (small) factor in determining national allocations from Cohesion Policy funding, as potential compensation for investment required for the achievement of the national non-ETS greenhouse gas target. ANNEX XXII to the Common Provisions Regulation, which spells out the elements that make up the allocation formula, adds in an element that allocates funding for a kind of "expected reduction effort required", measured by the distance between historic emission levels and the 2030 target level (1 EUR per tonne of CO2 equivalent per year is applied to the population share of the region).[16]
- **NECP recommendations**: As indicated above, the Common Provision Regulation specifically creates a link to the NECPs by referencing them as an input to Cohesion funding programming: "*Member States should take account of the contents of their draft National Energy and Climate Plan, to be developed under the Regulation on the Governance of the Energy Union, and the outcome of the process resulting in Union recommendations regarding these plans, for their programmes, as well as for the financial needs allocated for low-carbon investments*." (Recital 14, CPR (COM(2018)196))
- **NECP as a pre-condition:** There is also a thematic enabling condition for ERDF and CF (and ESF) that relates directly to the NECPs, saying that they should be "adopted and include: 1. All elements required by the template" provided in the Governance Regulation and "2. An indicative outline of envisaged financing resources" (see Annex IV to the CPR).[17]

[15] Moving to a low-carbon economy is one of 11 objectives in Regional Policy already (and thus for the ERDF and Cohesion Fund)
[16] The formulation in the Annex is, however, complicated and potentially open for misunderstanding – and language versions other than English (e.g. German) show that the formula requires clarification.
[17] This is connected to the specific objectives "2.1 Promoting energy efficiency measures;" and the one on NECPs also to "2.2 Promoting renewable energy through investment in generation capacity" under Primary objective 2.

Common Agricultural Policy:

- **Climate focus**: Also for the CAP the Commission wants to put "greater emphasis on environment and climate" (communication, p. 12), with "climate change action" as one of 9 objectives. And indeed, it proposes more stringent basic conditions in this regard (requirements for greening payments in 2013-2020 are now moved into the general set of conditions). However, environmental groups have criticised that additional flexibility given to Member States may weaken the impact of this change.[18]
- Member States will be obliged to offer a **voluntary "eco scheme"** to farmers willing to work under more environmentally friendly conditions.
- A **30% element of pillar II should be ring-fenced for climate**, which is new. However, the accounting for the current MFF indicates that spending under pillar II was almost 60% counted as climate related, which may make the 30% goal rather irrelevant.

In summary, the proposals published by the European Commission provide many references and the start of a direct link to the 2030 climate and energy governance process. However, as an anecdotal point: the term Energy Union is not mentioned at all in the MFF communication, which is an odd omission, considering previous emphasis on the concept in Commission publications. Furthermore, the Paris Agreement is also only referenced in passing (4 times incl. footnotes).

Integrating budget structure and Paris governance: key questions

Types of linkages between the NECPs and the MFF

To analyse the main questions underlying possible links between the NECPs and the MFF, different types of linkages can be distinguished:

a. An **alignment of strategies**: based on overarching objectives NECPs and financing strategies are coordinated and mutually consistent
b. The creation of direct or indirect incentives for setting **higher national ambition** for economy-wide or sector specific objectives
c. The creation of direct or indirect incentives for **effective implementation or good performance**, possibly beyond initial ambition

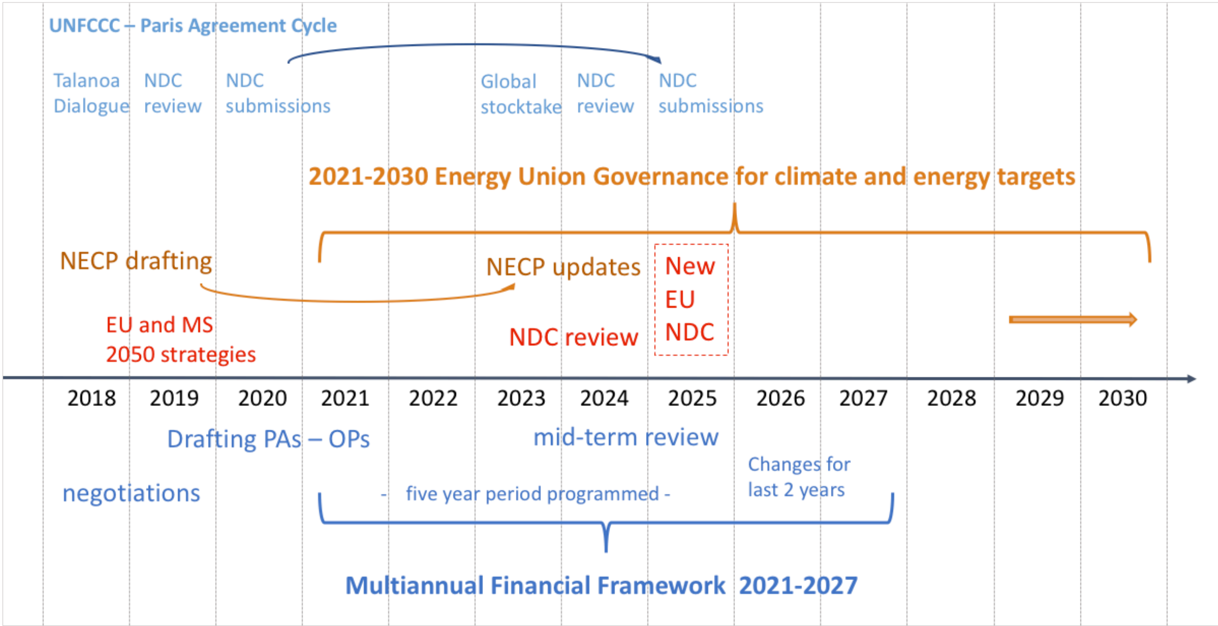
For each of these three types of links and examples exist in the current MFF system – or hooks have been created in the proposals for 2021-2027 – which are elaborated in more detail below.

Before that, it is worth noting, that the MFF's programming period (2019-2020) and the mid-term review (2023-2025), represent two possible interaction points between MFF and NECPs that already show a certain synchronicity between the two processes. The NECPs are also being drafted in 2018 and finalised in 2019 (possibly into 2020) – and undergo review in the period 2023-2025 in connection with the review of the EU's overall level of ambition (expressed in the NDC

[18] Alan Matthews (2018) The greening architecture in the CAP. http://capreform.eu/the-greening-architecture-in-the-new-cap/

submitted under the Paris Agreement)[19] – see Figure 4 for a visual representation of the respective timelines. This synchronicity could facilitate creating all three types of links identified.

Figure 4: Key strands in NECP and MFF timeline - interaction points in drafting and review phases



Source: own visualisation

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Alignment of strategies:

<u>Current practice:</u> The approach introduced by the current MFF, to adopt Partnership Agreements with each Member State across programmes, represents essentially a case of strategic alignment, in that overarching policy priorities are established and carried through to programmes covering different sectors. A similar approach had been pursued previously through "National Strategic Reference Frameworks" for 2007-2013, or the link to '20/20/20' targets during 2014-2020.

<u>Hooks in 2021-2027:</u> The new proposal seeks to continue the use of Partnership Agreements. The strategic planning dimension is strengthened in the new proposal in several places, e.g. through the new strategic plans in the CAP and the reduction of the number of objectives (in Cohesion Policy) and programmes, which can create a stronger focus and greater prioritisation. The emphasis on more frequent reporting and stronger performance evaluation contributes to this more focused approach. A key point in the Governance Regulation is that the mandatory template for the NECPs demands that Member States indicate (separately for the GHG, RE and EE targets) their intended use of EU funds. This information could push the door wide open for an alignment between NECPs and the MFF.

[19] For renewables and efficiency, similar reviews are due for 2024 and 2026, respectively, according to the recently agreed upon revisions of the respective directives (formal adoption later in 2018). EU ETS Directive and Climate Action Regulation also aim for 2023/4.

Possible realisation: Alignment could be best achieved through an explicit link created between the NECPs and the Partnership Agreements (and to the strategic programming for Cohesion Policy and the CAP Strategic Plans). NECPs are meant to include relevant information already and the CPR references this link, aiming to orient EU funds programming and mid-term review along 'country specific recommendations' stemming from the European Semester and Energy Union Governance process. However, this connection could result merely in the two processes mutually echoing one another – and not be based on an integrated strategic consideration of the most effective alignment of investment needs and what the MFF has to offer. As climate and energy objectives may be in competition with other priorities at the Member State level, this type of strategic alignment needs additional provisions. Among other options, such a stronger connection could be created through a higher climate mainstreaming share and more stringent binding qualitative requirements (e.g. in the CAP pillar I or in the definitions of thematic concentration).

Certain implementation processes (e.g. progress reporting and monitoring) could also be integrated with each other – both at the MS and the Commission's level (e.g. use of intervention field codes to inform also NECP progress monitoring – and an input to the State of the Energy Union report).

Rewarding ambition: ex ante incentives

Current practice: Means of setting out conditions for participation or access to funding exist in essentially all parts of the MFF in some form, e.g. the Ex ante conditionalities in Cohesion Policy, cross-compliance in the CAP (Statutory Management Requirements (SMRs) and Good agricultural and environmental conditions (GAECs)). The current CAP pillar I system of green payments for additional, environmentally more beneficial practices, is another specific example. There is thus, in principle, plenty of experience and there are existing routines and processes. However, the Cohesion Policy conditions are largely focused on compliance with the acquis and not of a qualitative nature (with the CAP conditions essentially are).

Hooks in 2021-2027: Cohesion Policy's ex-ante conditionalities are now to be called enabling conditions, which may sound less stringent – but the Commission asserts that the proposed practice would result in a stronger application. They are defined for each objective – and could in principle prevent certain funding purposes (those with insufficient "ambition") – although they are not currently defined in this way. The one that references the NECPs only checks if they exist and meet the formal criteria – but not a proposed level of national targets. Also, types of interventions could be removed from the list, signalling that certain activities are not eligible for funding. In the CAP, the proposal expands the cross-compliance requirements (e.g. by including new GAEC standards, previously considered especially "green", such as maintenance of permanent pasture and crop rotation). This type of approach essentially sets a minimum "ambition level" that needs to be cleared to access funding (the previous approach of a greening payment specifically opened a window for additional funding as a reward for higher environmental ambition). Moreover, in Cohesion Policy, climate is integrate as a (small) factor in deciding allocation, which could also be used for an increased ambition level.

Possible realisation: The strongest and most direct link with higher ambition on energy and climate in NECPs would be a higher overall MFF allocation to a Member State on that basis – but a similar link could also be made at a sectoral level (e.g. for agriculture under the CAP). Access to better financing conditions could also be an incentive that could be connected to higher level of ambition (such as increased renewables deployment). Any such approach would likely need to define thresholds for what would constitute enhanced ambition (must be clearly above minimum requirements) – and would need to consider the risk of creating incentives for low initial ambition pledges. A step in this direction would be the broader application of ex ante conditions (for all relevant funding instruments), as a minimum condition that Member States would need to meet. A key question in the creation of a financial incentive for higher ambition: where would the additional money come from? An ex ante set-aside or reserve may be required for such a purpose.[20] The proposed 'flexibility' reserve could be the source of such additional funding.

Rewarding performance: ex post incentives

Current practice: Performance monitoring and the possibility of an impact of (poor) performance on financing already exists in the current MFF. In fact, also a partial missing of ex ante conditionalities, for example, can result in lower actual payments. Performance related financial implications are thus in principle already established practice in the MFF. However, incentives for overperformance are not easily in evidence.[21]

Hooks in 2021-2027: The Commission emphasises the importance of performance in its proposal – and suggests elements strengthening monitoring (more frequent) and the process for annual performance reviews (under Cohesion Policy) – which are to culminate in annual performance dialogues between Member States and the Commission.

Possible realisation: Two types of performance related incentives could be envisaged: an exclusion approach, setting standards / eligibility criteria (minimum thresholds for participation) or a positive approach in which over performance unlocks additional finance or better conditions (e.g. lower co-financing requirements, additional access to InvestEU guarantees, etc.). These two could also be combined – and could in practice look rather similar. The key concept in connection to the NECPs would be to create an incentive to keep up effective practices (e.g. not roll back renewables support once a certain target has been met ahead of schedule) so as to move ahead with a transformative policy.

Moving the discussion forward

Many possible points arise from this presentation of the investment needs for the climate transformation, the Paris Agreement and its EU implementation via the Governance Regulation, the climate links in the MFF and the three ways in which connections could be created between

[20] Some of the options referenced have already been voiced by actors such as Climate Action Network Europe, see "Briefing: Assessment of European Commission's proposal for the EU budget 2021-2027", available at https://bit.ly/2u0PM8k
[21] The author would welcome pointers to relevant examples that may have escaped the research.

the NECPs and the EU budget. The following questions aim to capture the main dimensions that could help arrive at informed decisions for spelling out the connection between budget and climate action.

Principled dimension - questions on the concept itself:

- Shifting financial flows: does the overarching premise hold, that the MFF should be making a significant contribution to the EU's climate and energy objectives?
- How much is enough: what extent of linking between the processes is desirable?

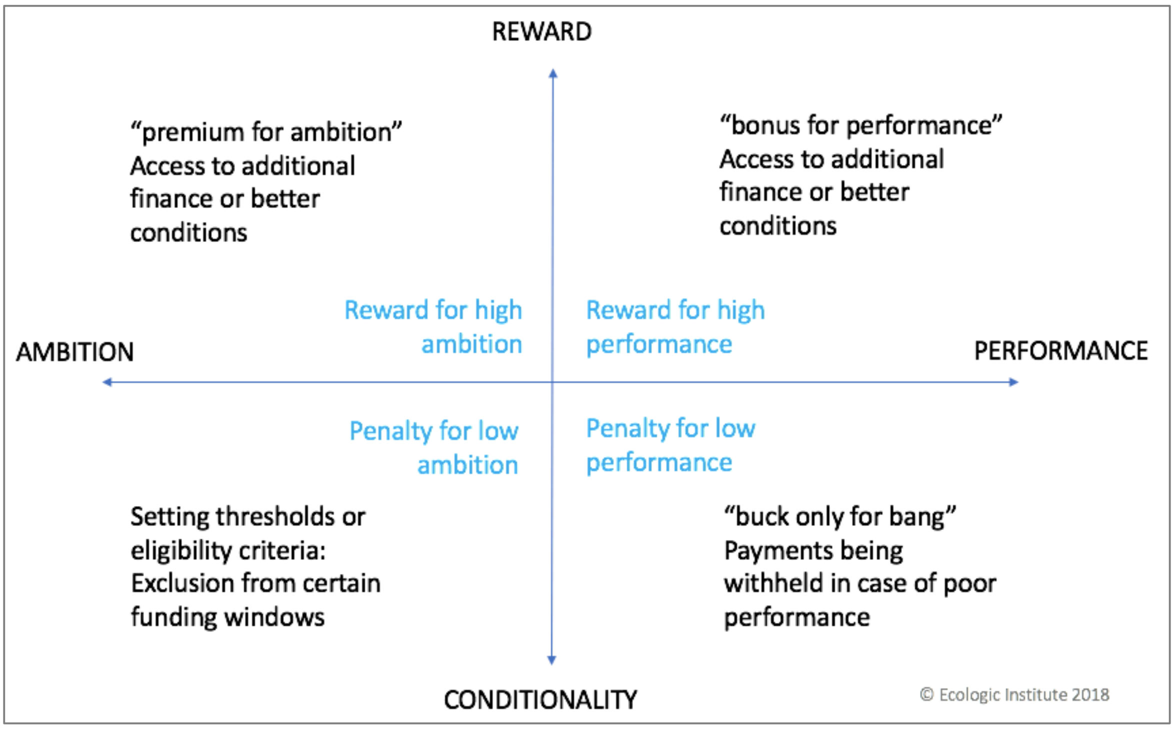
The "how to" dimension:

- What are the pros and cons of the three types of links (strategic alignment, rewarding ex ante ambition, rewarding ex post over performance)? See also Figure 5 below.
- Does the type of incentive matter? Positive rewards for extra efforts (carrots) or threat of penalisation through conditionality (stick)?
- What is the connection between discussing the MFF-NECP link and the overarching 25% climate mainstreaming objective?

Political economy dimension:

- Political sensitivities: Can allocation be touched?
- Where would any diversion of funds come from?
- Leveraging: Should the MFF focus more on leveraging additional financing to help bridge the investment gap for the climate and energy targets?

Figure 5: Different types of incentives that could be created in the MFF



ANNEX: List of activity codes for primary objective 2 of the ERDF and CF

Common Provisions Regulation COM(2018)375

ANNEX I

Dimensions and codes for the types of intervention for the ERDF, the ESF+ and the Cohesion Fund - Article 17(5)

TABLE 1: CODES FOR THE INTERVENTION FIELD DIMENSION

POLICY OBJECTIVE 2: A GREENER, LOW CARBON EUROPE BY PROMOTING CLEAN AND FAIR ENERGY TRANSITION, GREEN AND BLUE INVESTMENT, THE CIRCULAR ECONOMY, CLIMATE ADAPTATION AND RISK PREVENTION AND MANAGEMENT			
Code	**INTERVENTION FIELD**	Coefficient climate	Coefficient envir'ment
024	Energy efficiency and demonstration projects in SMEs and supporting measures	100 %	40 %
025	Energy efficiency renovation of existing housing stock, demonstration projects and supporting measures	100 %	40 %
026	Energy efficiency renovation of public infrastructure, demonstration projects and supporting measures	100 %	40 %
027	Support to enterprises that provide services contributing to the low carbon economy and to resilience to climate change	100 %	40 %
028	Renewable energy: wind	100 %	40 %
029	Renewable energy: solar	100 %	40 %
030	Renewable energy: biomass	100 %	40 %
031	Renewable energy: marine	100 %	40 %
032	Other renewable energy (including geothermal energy)	100 %	40 %
033	Smart Energy Distribution Systems at medium and low voltage levels (including smart grids and ICT systems) and related storage	100 %	40 %
034	High efficiency co-generation, district heating and cooling	100 %	40 %
035	Adaptation to climate change measures and prevention and management of climate related risks: floods (including awareness raising, civil protection and disaster management systems and infrastructures)	100 %	100 %
036	Adaptation to climate change measures and prevention and management of climate related risks: fires (including awareness raising, civil protection and disaster management systems and infrastructures)	100 %	100 %
037	Adaptation to climate change measures and prevention and management of climate related risks: others, e.g. storms and drought (including awareness raising, civil protection and disaster management systems and infrastructures)	100 %	100 %
038	Risk prevention and management of non-climate related natural risks (i.e. earthquakes) and risks linked to human activities (e.g. technological accidents), including awareness raising, civil protection and disaster management systems and infrastructures	0 %	100 %
039	Provision of water for human consumption (extraction, treatment, storage and distribution infrastructure, efficiency measures, drinking water supply)	0 %	100 %
040	Water management and water resource conservation (including river basin management, specific climate change adaptation measures, reuse, leakage reduction)	40 %	100 %
041	Waste water collection and treatment	0 %	100 %
042	Household waste management: prevention, minimisation, sorting, recycling measures	0 %	100 %
043	Household waste management: mechanical biological treatment, thermal treatment	0 %	100 %
044	Commercial, industrial or hazardous waste management	0 %	100 %
045	Promoting the use of recycled materials as raw materials	0 %	100 %
046	Rehabilitation of industrial sites and contaminated land	0 %	100 %
047	Support to environmentally-friendly production processes and resource efficiency in SMEs	40 %	40 %
048	Air quality and noise reduction measures	40 %	100 %
049	Protection, restoration and sustainable use of Natura 2000 sites	40 %	100 %
050	Nature and biodiversity protection, green infrastructure	40 %	100 %