Result oriented spending for the climate:

Creating strong connections between the EU budget and National Energy and Climate Plans

Discussion paper on integrating the 2021-2027 Multi-Annual Financial Framework (MFF) and the 2030 energy and climate target governance

DRAFT V1, OCTOBER 15, 2018 – by Matthias Duwe, Ecologic Institute (matthias.duwe@ecologic.eu)

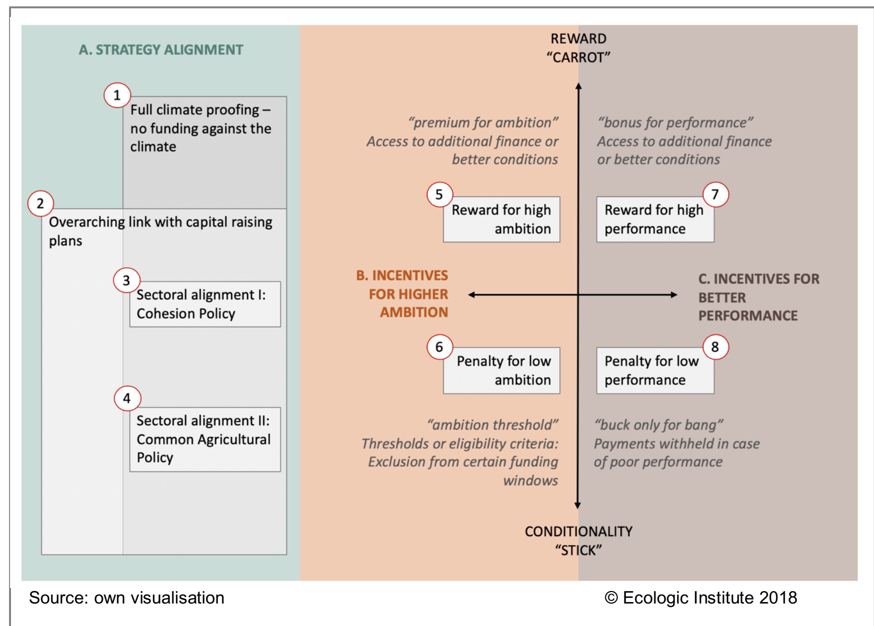
EXECUTIVE SUMMARY

The details of the future EU budget—the Multiannual Financial Framework (MFF) for 2021 to 2027—will be decided in the coming two years. In parallel, EU Member States have begun to develop integrated **National Energy and Climate Plans (NECPs)** (to be submitted at the end of 2018) and long-term climate strategies (due a year later), the success of which depends on a major shift in investments away from carbon-intensive practices towards climate-friendly projects and measures. This transition in financing must commence straight away in order to transform the EU into a carbon neutral economy in the space of a few decades. In short, the proposed MFF must actively support this transformation and the related investments.

Climate change is referenced in several places in the proposed MFF and its instruments. Still, in their current form run the risk of missing out on the potential benefits. Forging these linkages now would act as a strong signal for Member States, regional governments and private investors alike, and thus leverage more private investment to help achieve the EU's medium- and long-term climate goals.

Linking the MFF and NECPs: Three connection types

This paper discusses eight routes for connecting the proposed MFF funding instruments to climate and energy policy pursued at the Member State level (see Figure below). These can be categorized as one of three potential approaches (A) **alignment of strategies** between the national spending of EU funds and the NECPs, (B) financial **incentives for higher ambition** at the national level on targets and policies and (C) **incentives for performance** that deliver transformative impulses and emission reductions.



Source: own visualisation

© Ecologic Institute 2018

A. Strategy Alignment

Aligning the national spending of EU funds with the NECPs can be accomplished in four distinct ways. First a **full climate** proofing of the MFF would block funding for carbon-intensive (e.g. fossil fuel)

projects. All expenditure would need to pass a test ensuring that it is in line with and does not undermine the NECP objectives by causing additional emissions. A second route would establish **comprehensive national capital raising plans** to inform and help guide EU funding allocation. These plans could provide the fact base to decide policy details of the NECPs and inform MFF programming. Options three and four consider sector-specific alignment in regard to **Cohesion Policy and CAP funding informed by sectoral investment needs**. The proposed laws governing the Cohesion Funds contain the most explicit connections to the NECPs in the overall set of proposals; yet, these could be further strengthened by *inter alia* more direct reference to NECPs in Partnership Agreements and clear conditions. The new CAP Strategic Plans (SP) provide also a good basis for alignment, but the reference to the NECPs must be enhanced and detailed description of NECP related interventions included.

Merits: The overarching options 1 and 2 have the clear advantage of being comprehensive and promising the greates effect, as they influence all MFF spending in some form. However, if timing and other obstacles make their application difficult right now, a step-approach maybe possible, for example through the sectoral options 3 and 4. Few actual changes in the legislative proposals are required to create stronger linkages.

B. Incentives for higher ambition

Incentives for higher ambition could be implemented as either **higher funds allocation or better financing conditions for higher ambition** (a "carrot") or **ex ante conditions that establish general funding eligibility requirements** on the part of the beneficiary or for specific expenditures/activities (a "stick"). Especially regarding the former, several specific cases in MFF instruments and also in windows of the EU climate policy process can be identified that could warrant a dedicated incentive for higher ambition. To have financial resources available, **a "Paris Agreement Reserve" could be established**.

Merits: Sticks and carrots work well in combination—clearer conditions for stronger common standards coupled with the promise of higher funding allocation for going the extra mile form a robust incentive structure for climate action. Moreover, both incentive types could be implemented simultaneously using a staggered approach in which an initial set of conditions provides access to a share of the funding and an additional set opens up access to further funding. Precedence exists for both: The allocation formulas for regions in Cohesion Policy already include a climate element in the Commission proposal – and conditions for funding are well established (and the Common Provisions Regulation requires "approved NECPs").

C. Incentives for performance

The use of **penalties for poor performance** (option 7) already exists in the current MFF for climate and non-climate related objectives, and not meeting ex ante conditionalities, for example, can result in lower actual payments. B**ewarding good performance to avoid policy roll-back**. Installing a reward for going beyond what had seemed realistic in the past would certainly help to create a positive, self-reinforcing dynamic in which governments are not concerned only about ticking the box on an EU commitment but focused on the benefit to their national economy.

Merits: Performance would be measured over time – but setting clear rules on these now could also send an upfront signal. Both options could provide good added value and worthy of concrete consideration: integrating climate-related indicators into the catalogue for dedicated measurement of performance could also create a link to the Energy Union governance monitoring processes. And a "performance bonus" incentive could be enacted specifically for the mid-term review under Cohesion Policy.

-- END --

Introductory background I: Rationale for targeting EU funds

The details of the future EU budget will be decided in the coming two years. This next so-called Multiannual Financial Framework (MFF) will be in operation from 2021 to 2027. In parallel, EU Member States have begun to develop climate and energy policy for the medium (2030) and long term (2050), which will require investments to be shifted towards climate friendly practices and projects. This shift needs to start straight away to successfully move to a carbon neutral economy in the space of a few decades. The next MFF cannot turn a blind eye to the urgent climate investment requirements and instead must actively support this transformation.

Unlike national budgets, the EU budget is essentially an investment budget—and because its resources are gathered at EU level for the purpose of creating added value for the Union, it should support the achievement of jointly agreed EU policy objectives. At the same time, MFF spending can facilitate flexibility for Member States to pursue these aims in a way suited to respective national circumstances.

Granted, the MFF cannot finance the transformation alone, but it does not need to do so. A clear signal from the EU level that money is being directed towards the low carbon economy can have a strong guiding impact on national policies and on private and public investors. The spending signal from the MFF can thus pull along additional private investments and create a large and lasting leverage effect in favour of clean energy and emissions reductions.

Moreover, these types of investments promise significant additional economic and social benefits, through reduced energy imports, lower energy bills for households, better air quality and reduced health cost and also via additional jobs in sustainable business activities. Channelling EU funding towards climate and energy goals can thus also contribute to economic growth and greater well-being.

Introductory background II: Synchronicity of processes and existing links

EU energy and climate policy

For over four years, even prior to the adoption of the Paris Agreement (PA) on climate change, the EU has been preparing a legislative framework for its new 2030 climate and energy targets. The new regulatory framework fits within the overarching concept of the “Energy Union”, an approach to common EU energy and climate policy that is based on five pillars: energy security, an integrated energy market, energy efficiency, decarbonisation and research, innovation and competitiveness.

Informed by the objectives and processes adopted in the Paris Agreement, a suite of laws has already been passed (a last batch is still under negotiation at the time of writing) that establish EU and national targets for 2030 and the procedures needed to ensure their respective implementation and achievement. As part of this exercise, the EU’s governance system for energy and climate policy has been revised and now includes two new planning instruments to guide policy-making and investments (established under the Regulation for the Governance of the Energy Union, or Governance Regulation (GR) in short).

1) By the end of 2019 (formally on January 1, 2020), Member States must submit **long-term (climate and energy) strategies** that look at least 30 years into the future (2050) and chart a course in line with the PA goal of long-term decarbonisation. The European Commission must also produce a draft for a Union strategy in parallel (a first communication is presently expected for late November 2018). Nearly half of the Member States already have 2050 strategies.[1]
2) By the end of 2018, Member States need to draft new **integrated National Energy and Climate Plans (NECPs)**, which are subject thereafter to a European Commission review and should be finalised by end of 2019. The plans should have a clear focus on concrete policies for 2030 but also include a 2050 perspective and have to be consistent with the long-term strategies (Article 14.3 GR). The NECPs are required to follow a predetermined template, which obliges Member States to include specifics on their contributions to the EU-wide renewable energy and efficiency targets.

The NECPs will be implemented over the period 2021 to 2030, largely in parallel to the next MFF, and could therefore greatly benefit from targeted EU-level funding support. In fact, such financing could even make the NECPs more ambitious by raising Member States confidence about their (financial) capacity to undertake additional actions. The mandatory template for the NECPs includes this link to EU funding streams quite explicitly; for all five dimensions of the Energy Union (which provide the underlying structure for the plans) Member States are requested to list the projected use of EU funds. This requirement implies that national planners should consider in concrete terms how EU financing instruments can help implement the NECPs and achieve national objectives. Nevertheless, a conscious effort to strengthen this connection is warranted. An analysis of the **current EU budget expenditure shows that less than 8 percent** of Cohesion Policy funding (2014-2020) is directed towards the kind of actions the NECPs would contain.[2]

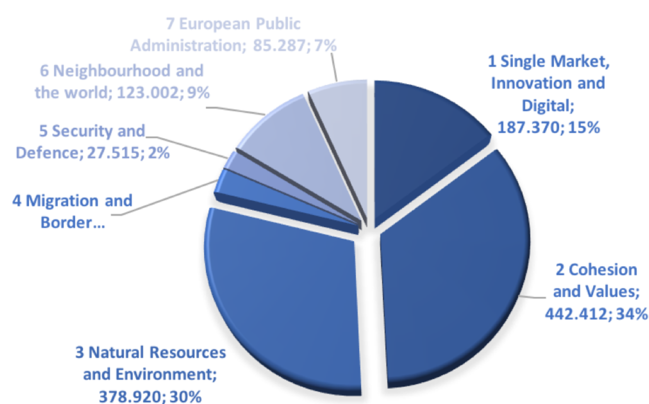
The Multiannual Financial Framework for 2021-2027

On May 2, 2018, the European Commission published a proposal for the future MFF and subsequently put forward drafts for all the legislative instruments required for its implementation. Compared to the previous MFF, the number of programmes has been reduced, but they are now organised into seven headings (instead of the previous five). Despite some reallocation, the spending still prioritises funding for Cohesion Policy and the Common Agricultural Policy (CAP), which together make up around two-thirds of the EU budget (see Figure 1). Accordingly, the vast majority of the budget will remain under shared management (where Member States organise final allocation and spending nationally, following agreement with the European Commission). The governance system for the spending of this money is thus of key importance, also in the context of the connection to climate and energy policy.

[1] See overview available from the Climate Recon 2050 Project at www.climatedialogue.eu
[2] Climate Action Network Europe (2018) Climate mainstreaming and climate proofing: the horizontal integration of climate action in the EU budget – assessment and recommendations. Brussels. http://www.caneurope.org/publications/reports-and-briefings/1646-assessment-and-recommendations-on-the-integration-of-climate-action-in-the-eu-budget

Climate change is referenced in several places in the overall MFF and in individual instruments. First, the Commission proposes that 25% of all funding should be dedicated to climate initiatives, both mitigation and adaptation (up from 20% under the current MFF). However, despite criticism of the existing procedures by the European Court of Auditors,[3] very few changes are foreseen in the way this spending would be accounted for and monitored. A number of the MFF legislative instruments list climate change as a key objective (e.g. the second policy objective in Cohesion Policy: "A greener carbon free Europe: clean and fair energy transition" [4]). The Governance Regulation is referenced in some instances and so are the NECPs. Climate policy is even meant to contribute to funding the MFF; the Commission has proposed that a share of the revenues from auctioning allowances under the EU Emissions Trading System should be channelled back into the EU fund.[5] Still, the existing linkages between **the MFF instruments** and national climate and energy targets **in their current form run the risk of missing out on the potential benefits**.

Figure 1: Proposed allocation to main headings in MFF 2021-2027 (in million €)



Source: Commission data, own visualisation

Parallel processes with two windows of opportunity

The fact that the MFF negotiations and NECP drafting processes are happening in parallel creates a unique opportunity for establishing concrete linkages between them in the period 2018-2020. However, there is an additional window of opportunity. The NECPs are due to be updated in 2023/2024, during which a general review of key pieces of EU energy and climate legislation is also set to take place in connection with the five-year cycle established under the Paris Agreement. Parties to the PA must submit their so-called nationally determined contributions (NDCs) in 2020, 2025, 2030, and so forth - following a stocktake exercise on progress towards the overall objectives. Parties are expected to subsequently increase the ambition of their NDCs strengthening climate action over time. The EU governance system for 2030 implements this five-year cycle through the NECP updates and the review of its climate and energy legislation. The MFF, as per the Commission's proposal, will also undergo a mid-term review, and therefore spending for the final two of the seven-year funding period could be altered on this basis (or only be programmed then).

[3] European Court of Auditors (2016) "Special Report No. 31/2016. 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". https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=39853

[4] Proposal for a Regulation of the European Parliament and of the Council on the European Regional Development Fund and on the Cohesion Fund, COM(2018)372

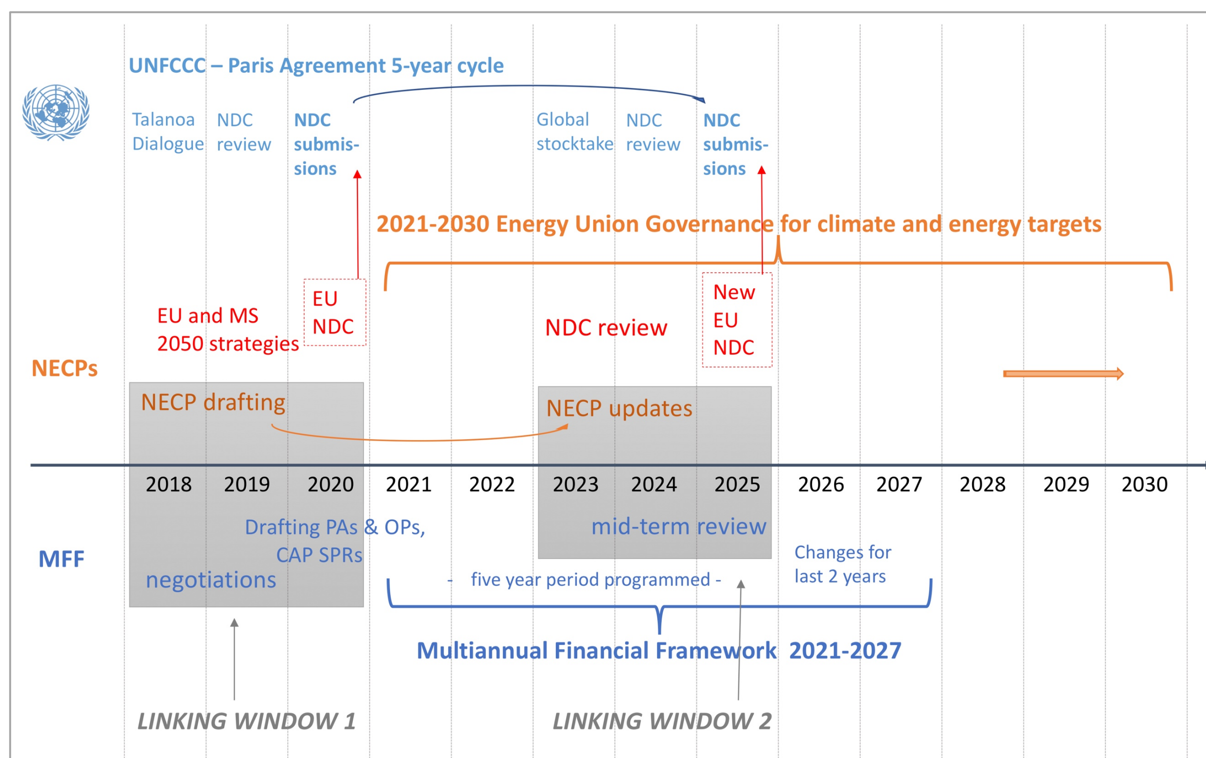
[5] Refer to subsequent sections and the previous paper in this series for additional information on the MFF's structure and climate elements in the proposals for 2021-2027.

Figure 2 shows the timeline of these processes over the period 2018-2030 and the linking windows:

1) 2018-2020: EU budget programming and NECP drafting,
2) 2023-2025: mid-term review of the EU budget and Paris Agreement cycle (EU target review).

The synchronicity of the reviews allows for learning and improvements and an intensification of the connection between EU budget programming and spending and the implementation of energy and climate objectives. Especially in the second linking window, when discussions on the MFF for 2028-2034 will take place, the experience gained until then can be taken up for further improvements.

Figure 2: Key strands in NECP and MFF timeline - interaction points in drafting and review phases



Source: own visualisation

© Ecologic Institute 2018

Linking the MFF and NECPs: Three connection types

A previous paper in this series explored the background of both the budget and the NECPs and distinguished between three essential types of connections:

1. An **alignment of strategies** between the national spending of EU funds and the NECPs
2. Financial **incentives for higher ambition** at the national level on targets and policies
3. **Rewards for performance** that delivers transformative impulses and emission reductions

This paper will delve into these three types more deeply, identify specifically in what ways the links could be created and discuss their respective merits. Table 1 below presents the main options considered under the scope of this analysis.

Table 1: List of main options for linking EU funding and national climate targets – along three types

Connection type	Main option
A. Alignment of strategies	1) Full climate proofing of the MFF
	2) Overarching link with capital raising plans
	3) Sectoral alignment I: Cohesion Policy
	4) Sectoral alignment II: Common Agricultural Policy
B. Incentives for higher ambition	5) CARROT: Higher allocation for more climate ambition
	6) STICK: Stronger ex-ante conditions to avoid low pledges
C. Rewards for high performance	7) STICK: Penalties for poor performance
	8) CARROT: Rewarding good performance – avoiding policy roll-backs

The ideas laid out in this paper are intended to provide food for thought for an ongoing policy-making process. The author explicitly seeks feedback on the options presented and is grateful for the many ideas and inputs received that have helped create the current version.[6]

Connection Type A: Alignment of strategies

Background: Rationale and opportunity

Arguably the strongest and most direct link between EU funds and the NECPs would be created if interactions between the two were proactively considered. This implies that connections would be established proactively in the initial drafting/development phases and not as an add-on after both processes have been designed independently of each other. The rationale for such an integration is simple: EU funding could then be directed in a targeted fashion where it is needed most to allow Member States to achieve their climate and energy goals.

On a practical level, such a targeted use requires data on the actual financing needs (both in terms of volume and sector) and an initial assessment of potential sources. A 2017 study commissioned by the European Environment Agency (Trinomics 2017) found that only a few Member States currently have a good overview of their own climate finance needs and spending (so-called *climate finance landscapes*).[7] The NECP exercise could be a driver for the establishment of such an overview of needs and potential sources.

As indicated above, the basis for this linkage exists in principle on both sides: the NECP template requests information on the use of EU funds and some MFF instrument proposals reference the NECPs (e.g. their establishment being an ex-ante condition for cohesion funding and

[6] The author acknowledges inputs received from colleagues at the European Climate Foundation and Climate Action Network Europe, as well as fellow experts at Ecologic Institute – with a special thanks to Nick Evans for editorial assistance.

[7] Trinomics (2017) Assessing the state-of- play of climate finance tracking in Europe. Final Report. http://trinomics.eu/climatefinancetrackingineurope/ . The report defines “climate finance “landscapes as the “systematic tracking of domestic climate investment and related financing flows” (ibid, page viii)

recommendations from the Energy Union Governance process being considered for the programming review). However, the existing legislative provisions provide no guarantee that the NECPs will contain the required information (or that Member States even possess the needed data) and nor can they ensure that EU funding will be directly targeted at NECP implementation. Under the current rules, the decision to use EU funds for this purpose lies essentially with the Member States. The competing interests and fragmented decision-making structures characteristic of national policy-making (in addition to the fact that some MFF spending decisions occur at a regional level) may hinder the optimal use of EU funds—even if there exists the intention to do so.

Available options

The existing practice under the MFF already includes strategic planning of expenditure, for example through the Operational Programmes under cohesion funding—enhanced in the current MFF with the conclusion of Partnership Agreements (between the Commission and individual Member States). The intention was to create an overarching mutual understanding of the ways that EU funding would contribute to overarching policy priorities.

The strategic planning dimension is further strengthened in the proposals for the 2021-2027 MFF:

1) In Cohesion Policy, Partnership Agreements are meant to be continued as the central governance framework. The number of Cohesion Policy objectives has been reduced to five and includes a clear climate focus.
2) As a new element in the CAP, strategic plans are meant to be developed, with a separate regulation proposed to establish the process and content of these plans as well as monitoring procedures.[8]

These two specific processes provide very clear entry points for a strategic alignment with NECPs and cover the majority of the MFF, but not all of it. More comprehensive options for strategic alignment would be needed to incorporate all EU spending. For the purposes of this paper, four main options for creating a strategic alignment have been identified and are analysed. These are not mutually exclusive.

1. **Full climate proofing** of EU funds with no spending against NECP objectives, reversing the burden of proof compared to the current system
2. An **overarching strategic exercise** done at the Member State level to establish investment needs and potential sources, resulting in a “capital raising plan” to then inform programming and funding decisions for all EU funding to that Member State
3. A sectoral version of this for the sectors and measures covered by **cohesion funding**
4. A sectoral version of this for **CAP funding** and the respective national goals and measures for the agriculture sector contained in the NECP

[8] Proposal for a Regulation of the European Parliament and of the Council establishing rules on support for strategic plans to be drawn up by member states under the Common agricultural policy (CAP Strategic Plans) COM(2018)392

A. Option 1: Full climate proofing of the MFF – a Paris Agreement compatible budget

The current MFF system (with a 20% spending target for climate) must check each instance and type of spending and assign a contribution (0%, 40%, 100%) to the climate spending objectives (the Rio marker system). Analysts argue that not all funding that is deemed climate-related should be counted as such and indeed that some activities attributed to the climate target might not represent clear climate values at all. Moreover, the funding not spent on climate activities could well counteract climate-related spending by investing in activities that generate greenhouse gas (GHG) emissions, such as industrial agriculture or carbon-intensive (e.g. fossil fuel) energy or transport projects.[9]

The most radical option for full and comprehensive alignment would be to implement a **100% climate proofing system for the MFF**. This would mean that all expenditure would need to pass a test ensuring that it is in line with the energy and climate objectives and does not undermine them by causing additional emissions. Simply put, this set-up would flip the burden of proof. Furthermore, it could be linked explicitly to the NECPs; any activity not foreseen in the plans would face extra scrutiny. If an activity is not included in the NECPs then why support it? And if a project that increases emissions is deemed to be vital on the grounds of national priorities, the resulting effect on emissions would need to be compensated by making an extra effort elsewhere.

There are elements in the current set of proposed instruments that would already complement such a system. As an innovation to the current system, Article 6 of the proposed regulation on the Cohesion Funds explicitly lists items that are excluded from the scope of the funds. The list includes "investment related to production, processing, distribution, storage or combustion of fossil fuels". Fossil fuel energy projects (except for gasification of transport) would thus not be eligible for funding under future Cohesion Policy. This type of exclusion of emission-intensive practices follows the climate proofing logic.

On a practical level, full climate proofing would need to be similarly enshrined in legislation through an explicit upfront reference to the NECPs and with clear exclusions of certain types of actions from funding. For example, the Cohesion Funds approach could be expanded and applied to instruments under both shared and central management. Certainly, for key energy and climate related instruments, such as the Connecting Europe Facility and InvestEU (a guarantee fund for large investments), similar guidance on project eligibility would make a difference for the climate-related impact of their financial resources.

As an interim step towards full climate proofing, a combination of a higher mainstreaming target with clear NECP links and scope exclusions could exercise a similar function and would represent a significant step forward compared to the current proposals.

[9] See for example analysis by the European Court of Auditors in footnote 3 above

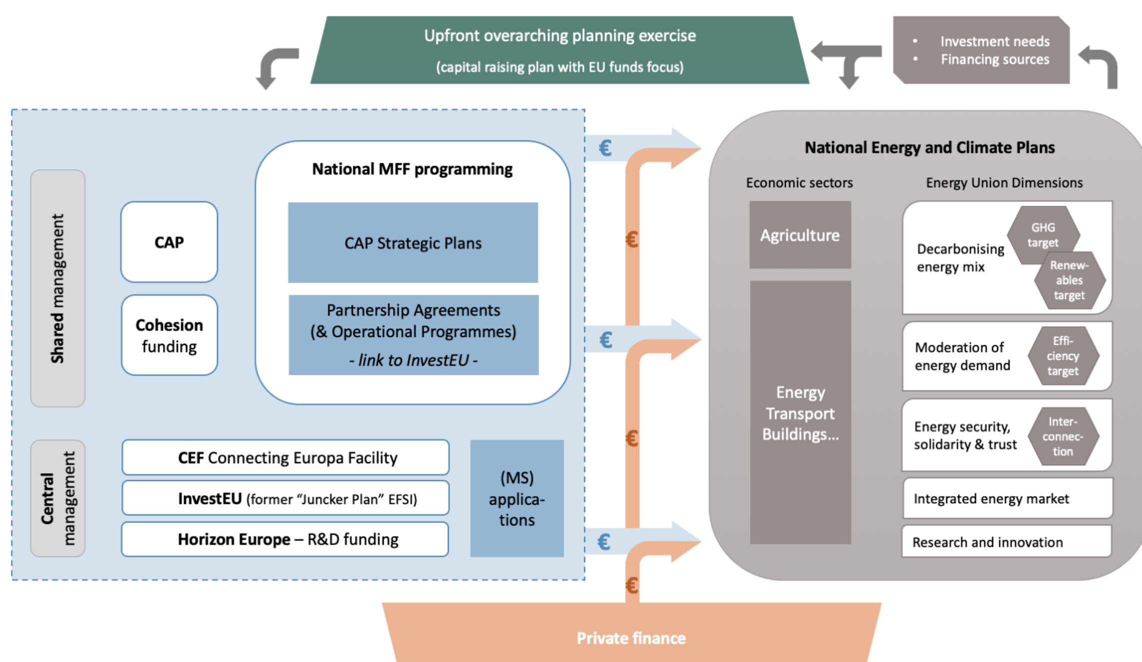
A. Option 2: Comprehensive national capital raising plans inform EU finance programming

Another option to achieve overarching strategic alignment with comprehensive coverage is to go through an ex ante **joint planning exercise,** which could help to identify how EU funds could best support NECPs. This would require a national assessment of the investments needs, based on a long-term decarbonisation pathway, to identify the respective national potentials for action with a focus on the 2030 timeframe. National planners must essentially already complete this task under the Governance Regulation, which calls for Member States to prepare 2050 strategies and chart their energy and climate policy options to meet GHG reduction obligations and set national energy targets for 2030.

The investment needs for 2030 have to be matched with an assessment of the available sources, especially where and how public funding might be best used to attract private investment. In this context, the role of the MFF and its instruments should be a central consideration. The result of such an exercise could be called a national "capital raising plan" (see Box on the next page). These plans could provide the fact base to decide policy details of the NECPs and inform MFF programming (see Figure 3 below for visualisation).

Having the respective information at the national level does not, however, provide any guarantee that EU funds will be used to support them effectively. As climate and energy objectives may be in competition with other priorities at the Member State level, this connection needs additional provisions in the respective EU legislation.

Figure 3: Strategic steering of EU fund use towards energy and climate goals - visualisation



Source: own visualisation © Ecologic Institute 2018

Explanatory box: EU Sustainable Finance policy and capital raising plans

The idea of including such capital raising plans in the NECPs or turning the NECPs into these plans, was mainly expressed in the related EU processes through the work of the High-Level Expert Group (HLEG) on Sustainable Finance, which published an interim report in July 2017 and a final report in January 2018—during the negotiations on the Governance Regulation. In the two HLEG reports, the concept was centred primarily on financing for infrastructure and technology/innovation. For comprehensive support of NECP implementation, the scope would need to be broadened to include the financing of policies that are geared towards other structural changes (e.g. building renovation or new agricultural practices).

The EEA endorsed this concept in a July 2017 briefing, building on a detailed assessment showing that few Member States even had information on investments needs and financing plans available. The European Commission, which drew on the HLEG reports for their Action Plan on Sustainable Finance (March 2018) and the three related legislative proposals it published in May 2018, did not pick up explicitly on the concept in any of the documents. However, related recommendations (such as the creation of a harmonised taxonomy on sustainable finance products) are now proposed for implementation and could support better climate finance tracking in the future.

The **Governance Regulation**, which could have supported strategic alignment between the MFF and NECP process in this regard, has already been adopted and negotiations cannot reasonably be expected to be reopened prior to the start of the next MFF in 2021 (a formal review is foreseen for 2024). However, there may be some scope in the further specification of elements to be decided via implementing and delegated acts. Furthermore, as draft NECPs are meant to be submitted by the end of 2018, followed by a Commission evaluation that must be provided by end of June 2019 at the latest, there is scope for a focus in this assessment on the details that Member States provide in their NECPs and request additional information for the final versions.

In the **MFF proposals**, there are several ways in which the connection could be strengthened to allow for overarching strategic alignment to take place. The essential levers are: referencing the NECPs and making the link mandatory as well as including instruments that direct more spending to climate related activities. Creating the link in these ways does not depend on the existence of capital raising plans—of course, having them would lend credibility and political attention (in deciding MFF spending) to the strategic focus on NECPs. All of the options explored in this paper would make contributions to this type of connection. The following list thus focuses on the points that are not explicitly addressed in other sections.

- **Direct reference to NECPs** and their objectives in all relevant MFF instruments. All MFF instruments could specifically mention the importance of information from the standpoint of an investment needs assessment (in the NECPs) to help guide spending. Options 3 and 4 (the following two sections) explore programming under shared management, i.e., Cohesion Policy and the CAP. However, similar direct reference could be required for the centrally managed instruments (such as InvestEU and CEF). The CEF Regulation, for example, states that NECPs should be taken into account (Article 13 'Award criteria'), but

could this connection could be further enhanced to qualify how the NECP connection would be assessed in deciding on the application of funds.

- Expansion of the respective **conditionalities** that could reinforce this link (e.g. stronger explicit ex-ante enabling conditions in the cohesion funding that requires NECPs). This is elaborated in more detail in options 3 and 4 below and in the chapter on “Connection Type B: Incentives for higher ambition”.
- Setting **mandatory shares** of climate-related financing in all MFF instruments. Currently, allocation shares are almost exclusively indicative and thus render spending towards NECPs objectives voluntary.
- A **higher overall climate mainstreaming** target for the budget could also enhance the push towards spending being aligned with energy and climate targets.

In addition to the changes in the legislative proposals, political announcements could underline the connection further, such as:

- A **high-level political support statement** on the importance of the strategic link between MFF and NECPs in relevant EU fora, e.g. at the May 2019 Sibiu summit on the future of Europe or at other Council meetings (e.g. in the context of negotiations on the overall MFF).
- The European Commission could use the State of the Energy Union in the first quarter of 2019 to underline the connection and signal its intent to monitor alignment in their **assessment of Member States NECPs** and issue respective country-specific recommendations (following Article 28 GR). The use of EU funds could also become an indicator in the progress monitoring of the Energy Union.

A. Option 3: Sectoral alignment I: Cohesion funding informed by sectoral investment needs

The proposed laws governing the Cohesion Funds contain the most explicit connections to the NECPs in the overall set of proposals. The recital declares clearly, “*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)). While this sentiment is echoed in the legal provisions, they do not provide the same degree of clarity.

Specifically, one of the enabling conditions for policy objective 2 (“A greener, low-carbon Europe”) requires that countries have their NECPs approved—the enabling condition does not, however, require any specific quality of the plans (e.g. a level of ambition or degree of detail provided).[10] The text also states explicitly that the plans should include an “indicative outline of envisaged financing resources and mechanisms for measures promoting low-carbon energy”, which may be read as a

[10] Common Provisions Regulation, COM(2018)375, Annex IV

requirement for a kind of capital raising plan even though the investment needs are not plainly referenced. It also foresees that Member States should take into account relevant country specific recommendations stemming from the monitoring process of the Energy Union governance, e.g. in the mid-term review. As a particular feature of cohesion funding, the regulations also require a mandatory share of the expenditure to go towards policy objective 2, although not for the most economically advanced Member States.

Therefore, there is already a solid basis for an upfront direct link between the MFF and NECP processes that could result in strategic alignment, but the strength of this connection depends on the decisions made by Member States. There are several ways in which this connection could be bolstered and anchored more strongly in the legislation:

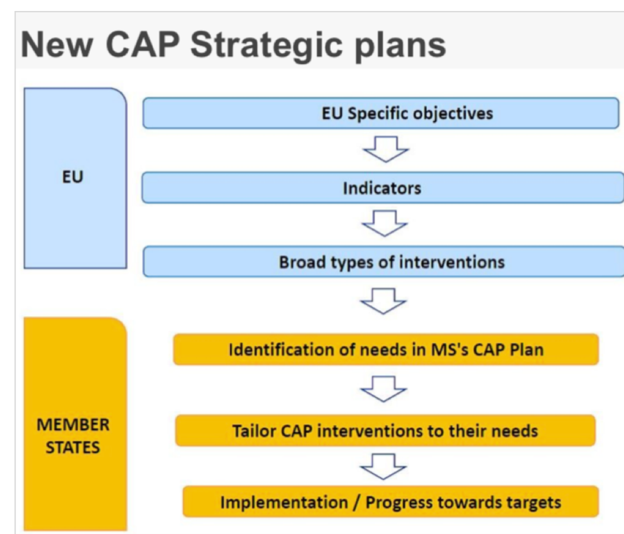
- Including **reference to the NECPs** throughout the regulations on the funds and the common provisions for them, more specifically in the objectives and implementation processes (incl. programming, monitoring, review process, etc.), and not just in the recitals.
- Adding a **requirement that Partnership Agreements** must be drafted with the NECPs integrated in—via provisions in the CPR (Title II “Strategic Approach”, Article 7 on Preparation and Submission and Article 8 on Content).
- Accounting for the NECPs and their objectives concretely in the **operational programmes** (CPR Title III “Programming”).
- Setting a mandatory **minimum share of spending on policy objective 2** for all Member States that is **higher** than presently foreseen.
- Making even more explicit in the legislation the link between the **mid-term review** (Article 14) of the Partnership Agreements and the NECPs and their respective foreseen updates (and progress monitoring process under the Energy Union)—to open the “linking window 2” (see Figure 2).
- The mandate given to the Commission to **request improvements** to programmes (which is established in Article 15 CPR) should include NECP implementation considerations (for example, on the basis of country-specific recommendations stemming from the progress monitoring processes established under the Governance Regulation).
- Data points that relate to the NECPs and their implementation should be incorporated into the **performance monitoring system** and the respective distinct indicators in order to more clearly signal the connection between NECP implementation progress and spending performance.
- Lastly, the Governance Regulation **reporting** and cohesion reporting processes should be integrated (e.g. through the use of intervention field codes to inform also NECP progress monitoring—and become an input to the State of the Energy Union report).

A. Option 4. Sectoral alignment II: CAP funding informed by sectoral investment needs

The agricultural sector and its practices are a significant element in most Member States' annual emissions, and related improvements could make a substantial contribution to meeting the 2030 climate targets. Climate change is recognised in several places in the draft laws for the future CAP. Article 6 of the Regulation on CAP Strategic Plans, for example, lists as one of its nine objectives the need to "contribute to climate change mitigation and adaptation, as well as sustainable energy".

These Strategic Plans (SPs) for the CAP are an innovation in the proposals for the future MFF. Indeed, the Commission's draft CAP regulation foresees more subsidiarity and flexibility for expenditure at the national level. The intended function of the SPs is to facilitate a common understanding between the EU and its Member States in order to ensure a minimum level of guidance and create transparency about where the national expenditure would take place.

Figure 4: Visualisation of the MFF's translation of EU objectives into the CAP Strategic Plans framework



Source: Emil Erjavec "CAP strategic planning: scope and implications" July 2018 presentation, slide 4

The CAP SPs are in some respects much like the NECPs, but the draft Regulation (CAP SPR) has more detail and is more specific about contents and process compared to the Governance Regulation, which leaves certain reporting details to be decided at a later stage, for example. An important element relevant to strategic alignment with the NECPs is that the SPs **require a needs assessment** to be carried out. The plans also have to specify financial allocations for each intervention. Furthermore, the proposed regulation includes a dedicated approval process, which allows for the possibility of amendments, and the performance framework it establishes to monitor progress includes annual reporting.

For the rural development part of the CAP (the European Agricultural Fund for Rural Development (EAFRD)) a binding share of 30% is laid down in Article 86.2 of the CAP SPR for climate related expenditure. However, for direct payments under the European Agricultural Guarantee Fund (EAGF) no binding share is foreseen.

In a communication issued in November 2017 as part of the process preparing changes to the CAP system, the European Commission referenced the Paris Agreement and declared its expectation that "Member States will take into account their planning tools adopted emanating from EU environmental and climate legislation" when preparing CAP SPs, but failed to explicitly mention the NECPs.[11] Furthermore, the communication indicates clearly that the Commission will assess and

[11] European Commission (2017) The future of food and farming, COM(2017)713, p. 9

approve CAP SPs "with a view to maximising the contribution of the CAP towards (…) the achievement of Member States' climate and energy targets".[12]

This strong statement is not immediately reflected in the proposed legislation, but a basis is provided. A reference to the Governance Regulation—as one of several relevant EU laws (incl. the LULUCF Regulation and the Climate Action Regulation (CAR))—is included (Article 7 CAP SPR) in addition to possible indicators stemming from it (Annex XI CAP SPR) in a provision meant to ensure "consistency with other Union policies". However, the NECPs are not mentioned.

This groundwork for linkages between the CAP and other EU laws clearly opens the door to a connection between CAP funding and the NECPs from the outset to allow for a strategic alignment. However, the legislation could be improved with the following changes to realise this for all Member States.

- Strengthening the existing link to the Governance Regulation in the CAP Strategic Plans by including an **explicit reference** to specific policies and measures for the agriculture sector foreseen in the NECPs and **requiring detailed description of interventions** through which these will be achieved.
- Making it mandatory that the envisioned SP **needs assessment** and the setting of goals are **linked to the NECPs** specifically (and their respective needs assessments)—and laying out how these contribute to longer term objectives for climate and energy.
- Establishing a **binding climate spending share for the EAGF**—and raising the share for the EAFRD.
- Establishing **annual progress indicators connected to the NECPs** (currently already relevant) to signal the importance of directing spending towards related activities and including these in the annual performance review.

Beyond these amendments to the legislation, the implementation of procedures for adopting and checking on the plans are important. The Commission could reiterate its announcement of a strong focus on NECPs in the assessment of the CAP SPs – and then follow through with it in implementation.

Merits of the options

The four main options presented are related in several ways. An overarching strategic alignment along the lines of the first two options implies that alignment filters down, or rather, is implemented via the sectoral instruments and would thus require also some of the suggested changes in the draft legislative proposals Cohesion Policy and CAP.

In all cases, an increase in spending earmarked for climate action would help, and making this binding for all instruments would further support alignment. Nevertheless, a clear advantage shared

[12] ibid. p. 10

by the two overarching options is that they would create the strongest signal for relevant actors, including potential private investors and capital markets.

All options would benefit from an assessment of Member State investment needs, implemented as part of the NECP drafting. In short, having detailed and robust reports on financing requirements could create a strong "pull" effect for MFF financing. A key practical question is whether Member States have access to data as well as the capacity and planning time to develop comprehensive capital raising plans. The solution to this as a potential bottleneck may lie in a step-by-step approach, e.g., starting with sectors/activities where data is more readily available or providing support on these matters from the EU level. However, even without a comprehensive assessment, the moment that an NECP states that some planned policies require funding, this starts to formulate the expectation of a concrete link to the future MFF.

Strengthening key provisions in individual MFF instruments is essential to opening the door for this type of alignment, in other words, to help "push" funding in the right direction. The draft legislation on the Cohesion Funds already has the most explicit references to the NECPs so even minor changes in the legislation could strengthen this connection considerably. The SPs under the CAP have little direct reference, but they themselves signify a robust planning process. They require even more detailed specification than the NECPs, including a needs assessment and clear annual performance monitoring (the NECPs only have this every two years). Again, small amendments to the legislation here could make a substantial difference.

In summary, it is clear that every move towards a more direct link between the MFF instruments and the NECP process helps to build alignment. This includes direct reference to NECPs in strategy formulation and programming, clearer conditionality, mandatory climate shares, better tracking, inclusion in the performance review and a focus on EU fund use in the drafting of the NECPs and the Commission's review of them.

Connection Type B: Incentives for higher ambition

Background: Rationale and opportunity

The establishment of the new governance system for energy and climate policy has had several drivers. One of these has been the shift away from binding national-level renewable energy targets. For 2020, this target was formulated as legally binding for Member States, but for 2030, targets are determined by Member States and not directly binding as such. Still, the respective EU-level objective for 2030 *is* meant to be binding, which could result in inconsistency between EU-level ambition and aggregate Member State action. Member States also get to decide their own energy

efficiency objectives—only the targets for GHG emissions from sectors not covered by the EU Emissions Trading System (ETS) are established already in legislation.[13]

All of these targets (or: national contributions) have to be included in the NECPs. For the energy targets this information serves as the basis for an assessment of the overall level of action on renewables and efficiency at the EU level to identify possible ambition gaps. NECPs thus become the vehicle through which Member States communicate and justify their energy and climate targets as well as how they intend to achieve them.

Public funding, especially external to national budgets, such as from the MFF, could help realise energy savings, support renewables deployment and fund GHG emissions reduction policies, partly by directly funding the actions and partly by attracting private finance. Thus, the **promise of access to funding might unlock** additional actions or **higher ambition by Member States** on energy and climate targets.[14]

Access to funding can be used to create both positive and negative incentives, essentially as "carrots" or "sticks". A *carrot*, for example, could be the promise of additional funding after achieving a certain level of activity. A *stick* would, e.g., only allow access to funding after a minimum achievement has been met. These could easily be combined in a staggered system of incentives.

The promise of additional funding (the "carrot") brings with it, of course, the question of where the money would come from (a "Paris Agreement Reserve"?), which cannot be addressed to the level of detail required under the limitations of this paper – and specific ideas in this regard are only mentioned in certain instances.

Available options

The MFF system certainly already contains both *carrots* and *sticks*. On the one hand, there are numerous types of minimum conditions that serve as eligibility criteria for funding, which act like *sticks*. On the other hand, there are several elements that identify differences between countries and distinguish between them in terms of their treatment under individual instruments; these can be used as both *carrots* and *sticks*. The design of the next MFF could thus provide financial incentives for countries to pledge higher targets in their NECPs. The main options identified here are as follows:

1. CARROT: Receiving a higher allocation for additional climate ambition (and/or better conditions)—differentiated by instrument and in time.
2. STICK: Stronger ex-ante conditions to avoid low pledges

[13] Climate Action Regulation: Regulation (EU) 2018/842 of the European Parliament and of the Council of 30 May 2018 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement and amending Regulation (EU) No 525/2013

[14] While the non-ETS targets are set in the CAR, Member States are free to set national objectives that go beyond these minimum requirements.

B. Option 5: Higher allocation for more climate ambition (and/or better conditions)

The allocation of funding is managed differently for the main instruments. For the shared management elements of the EU budget, the distribution to Member States is decided upfront (e.g. in the CAP) or follows a dedicated formula (e.g. Cohesion Policy), resulting in so-called pre-allocated national envelopes. The centrally managed funds generally work on an application basis and do not have Member State-specific envelopes.

The allocation of funding is inherently a politically sensitive matter. The EU budget negotiations are historically known for controversy (e.g. around the national rebate for the UK). However, the tension could potentially be overcome if a climate-related dimension for allocation (especially regarding pre-allocation for CAP and Cohesion Policy) were to be introduced and agreed upon upfront as part of the overall compromise on the MFF. If funding for additional climate allocation would come from a dedicated reserve and thus not infringe upon Member States' claims to their envelopes, this might also reduce friction.

> Note to readers: dedicated analysis would be required to establish a possible monetary value that could act as an incentive. This would certainly differ for each additional unit of GHG emissions, energy saved or renewable energy produced. The value of additional EU funding can also be expected to be judged differently between different Member States, e.g. based on their respective dependence on these funds. An attempt to quantify a range of possible monetary incentives is beyond the scope of this paper.

How could such an incentive be implemented concretely in the MFF, and under what circumstances might it be considered? There are a number of specific cases that can be identified. Seven of these are considered individually in the following subsections.

Specific case I: Upfront incentive to all Member States for higher pledges

In principle, the promise of additional funding based on extra action would act as an incentive for Member States to include higher targets in their NECPs. Any such approach would need to **define what would constitute enhanced ambition** in addition to considering the risk of creating an incentive to offer low initial ambition pledges. The latter could be guarded against by establishing a baseline for the respective national targets, which would serve as a minimum threshold. Considering the different rules governing GHG, renewable and efficiency targets, these would each need to be treated separately:

- GHG emissions: The binding national non-ETS targets in Annex I of the CAR (2018/842) would set a clear minimum threshold that could be used as baseline ambition.
- Renewables: While there are no pre-determined national target numbers included in the Governance Regulation or the Renewables Directive, Annex Ia to the former contains a formula that the Commission may use to assess the adequacy of a Member States' proposed renewable energy contributions. This formula could also be applied to establish a minimum threshold to define baseline ambition.

- Efficiency: There is no formula for the calculation of a benchmark for the national energy efficiency targets included in the Governance Regulation. The law refers instead to "modelling exercises in relation to future trends in energy consumption and other complementary analysis" (Article 27.1a GR). A separate analytical exercise would thus be needed to establish a minimum threshold to count as a potential baseline.

Specific case II: a gap in the collective ambition for the energy targets

As described above, Member States set their own national contributions to the 2030 targets on renewables and efficiency and inscribe them in their draft NECPs. The Commission will then assess the plans and check to see if the sum of the individual contributes matches with the EU-level objective. If this is not the case, the Commission can issue country-specific recommendations to those Member States that it considers having made insufficient contributions. For renewable energy, a formula is available to provide guidance on what counts as an adequate contribution for each Member State, giving the Commission more leverage to demand an improvement. Such a formula does not exist for energy efficiency.

Should the overall target not be accounted for by the sum of the contributions, the gap could in theory be filled by voluntary additional effort by a Member State that the Commission has judged to have already proposed an adequate contribution. Such a procedure is not foreseen in the processes established under the Governance Regulation, but it is also not excluded—and a political agreement on how to fill potential gaps may be deemed by many Member States a better outcome than alternatives, such as additional legislation. Additional voluntary gap filling contributions could be rewarded with the promise of additional EU funds allocation.

Specific case III: Post-NDC increase moment, extra funding for voluntary GHG reductions?

One case concerns 2020, at which point the EU will need to decide what to submit as its revised NDC under the Paris Agreement (see also Figure 2 in the introductory background). The current NDC (submitted formally in early 2016, after the adoption of the Agreement) is an overall EU target of 40% reductions over 1990 levels by 2030. This figure is based on a Commission proposal dating from January 2014, which was validated by EU heads of state and government in October 2014—alongside a 27% increase in renewable energy and 27% reduction in energy consumption (against a baseline projection). The latter two targets were increased, to 32% (renewables) and 32.5% (efficiency), respectively, as part of the final compromise on the respective legislation (including the Governance Regulation) in June 2019. The GHG target has not been adjusted in kind.

Calculations by consultancy Ecofys show that the implementation of the higher energy targets alone "would result in an emissions reduction of approximately 46%", with additional non-energy actions bringing the cut to almost 50%.[15] European Commissioner Cañete has made several public statements to similar effect, mentioning a figure of 45% GHG emission reductions. In the context

[15] Ecofys (2018) News. 32% renewable energy and 32.5% energy efficiency targets enable emissions reductions of approximately 46% for EU. https://www.ecofys.com/en/news/32-renewable-energy-and-325-energy-efficiency-targets-enable-emissions-redu/

of the EU2050 strategy, and the Paris Agreement's procedural step of an updated NDC submission foreseen for 2020, the EU could decide to indeed raise its official international climate target.

The EU's GHG target is formally divided into two main elements. One is comprised of emissions governed by the Emissions Trading Directive and the other accounts for the remaining share of the emissions broken down into (non-ETS) national targets. A change in the overall target could thus trigger changes in either or both elements and thus also lead to adjustments in the binding national targets. This would in turn affect the NECPs.

An upwards revision of the EU NDC in 2020 could thus either be preceded by a request for (voluntary) additional GHG reduction commitments by Member States or it could trigger such an exercise. In either of the two situations, an offer of additional allocation of funding from the MFF could be used provide Member States with an incentive to pursue more ambitious climate action.

Specific case IV: Mid-term review moment

Another case in which the promise of additional funding could be particularly advantageous is during the NECP updates and the MFF mid-term review. In principle, this would be similar to the *ambition* gap-filler case described above, but function instead as an *implementation* gap filler. This option will be described in more detail under "Rewards for performance" in section C.

Specific case V: Cohesion funding allocation formula

The main method for allocation under the Cohesion Funds is described in Annex XXII of the Common Provisions Regulation. It spells out three formulas, each to be used for a different predefined type of region (with different levels of economic prosperity). Each Member State's territory is broken down into regions and each of them is matched with one of the three formulas—so that the sum of the regional allocations determines the overall national envelope.

The formulas presented in text form already contain an element that references the non-ETS GHG emissions targets, which could be built upon. However, the language produced by the European Commission is inconclusive as to the incentive it presents. The English text reads:

> *"f) to the amount obtained (…) is added, if applicable, an amount of EUR 1 per tonne of CO2 equivalent per year applied to the population share of the region of the number of tonnes of CO2 equivalent by which the Member State exceeds the target of greenhouse gas emissions outside the emissions trading scheme set for 2030 as proposed by the Commission in 2016;"*

Other language versions of the draft Regulation send differing signals in this regard—pointing to a lack of clarity in the legal language even for professional interpreters. One way to read the text is that the "required reduction effort" for each Member State (difference between historic emissions and 2030 target) is measured and factored into the allocation in such a way that more money would be given to those who need to make more reductions. In principle, this effort-based allocation is sensible as it attaches value to the reduction action itself. However, connecting this to historical

emission levels may reward Member States who have reduced their emissions less in the past. It also does not set an incentive for any additional action.[16]

To create an incentive inside the allocation formula, the text would need to indicate that an extra allocation can be made when a Member State decides to go beyond the Non-ETS target that has been decided under the CAR.

Explanatory box: Cohesion Policy allocation formula and NUTS

The NUTS (Nomenclature of territorial units for statistics) classification is a system to divide the European territory in hierarchical economic sections: NUTS 1 represents the "major socio-economic regions", NUTS 2 the "basic regions for the application of regional policies", NUTS 3 the "small regions for specific diagnoses".

For Cohesion Policy purposes, NUTS 2 (which include regions from 800,000 to 3,000,000 inhabitants) is divided into 3 categories: less developed (GDP per inhabitant less than 75% of the EU-27 average), transition (between 75% and 100), more developed (above 100%). Priority for cohesion policy funding is given for less developed regions.

Specific case VI: CAP funding allocation

Previous CAP reforms have already led to significant changes in the distribution of funds among Member States,[17] so adjustments to the CAP allocation are not unusual for a new MFF. The practice of granting additional funding to compensate temporarily for the additional effort required by moving to more climate friendly practices is also current practice under both pillars of the CAP (i.e. greening payments under pillar I and agri-environment-climate (AEC) payments under pillar II). The CAP is thus in principle particularly suited for the introduction of an upfront incentive for higher climate ambition at the national level.

The pre-allocated national envelopes for the CAP are the sum of two separate amounts: Annex IV of the CAP SPR contains the allocation per Member State for the EAFRD (as per Article 81 CAP SPR), and Annex IX contains the allocation per Member State for the EAGF (referenced in Article 83). While the explanatory part of the CAP Regulation mentions calculations and objective criteria for the disbursement of funding, there is no formula contained in either one of the two regulations or their annexes.

Attaching a dedicated element to the allocation foreseen on the basis of additional climate ambition could thus be implemented in the form of creating an optional bonus for those Member States. This could be linked to the overall climate change ambition displayed by the NECP, or also to a dedicated effort to reduce the emissions in the country's agricultural sector (such as a separate sectoral target, which feeds into the country's non-ETS target). It could also be a combination of both (a dedicated sectoral target leading to an overall higher non-ETS reduction than mandated by

[16] If allocation were not decided for the whole MFF period, a variant of the text from the proposed CPR could also be provide a reward for overachievement of the binding non-ETS target (e.g. at an interim allocation point like the mid-term review). This would then function as a good performance reward—which is discussed further in section C.
[17] European Parliament (2015) Implementation of the first Pillar of the CAP 2014 – 2020 in the EU Member States. Study. p. 38

the CAR). The new Agricultural Reserve could serve as a source for such higher allocations. It could be increased by setting aside a larger share upfront, to strengthen the incentive provided.

Specific case VII: Better conditions (co-financing rates or better guarantees) for higher climate ambition

A slightly different but similar type of *carrot* could be created by offering not an upfront allocation increase, but better conditions for access to money. This could include, for example, better co-financing rates (meaning a higher share of funding being covered by EU funding) or access to more guarantees to help leverage private capital.

Such differential treatment already exists in the MFF at present, for example, with better conditions for economically less developed regions and the current proposals repeat this (e.g. Article 106 CPR). Rewarding special effort on environmental and climate grounds is also already a recognised option under the CAP (see also previous specific case).

A special climate-related incentive in the form of better co-financing could be included in many instruments under the MFF. As one specific example, Article 106 of the CPR on "Determination of co-financing rates" could include a dedicated climate-related component and spell out a higher general share of co-financing for climate related activities—especially going beyond a certain standard (e.g. a threshold defined in the conditions). Another example could be to give access to additional InvestEU guarantees to Member States pledging higher national targets on GHGs, renewable energy or energy efficiency in their NECPs.

B. Option 6: Stronger ex-ante conditions to avoid low pledges

An altogether different approach incentivising higher climate ambition would redefine the rules that govern access to funding in the first place. Such ex ante conditions establish general funding eligibility requirements on the part of the beneficiary or for specific expenditures/activities. Such eligibility conditions serve as a test thus establishing a minimum threshold under which funding is blocked. Unlike the methods of positive reinforcement discussed above (carrots), these types of incentives are "sticks" because they essentially punish (i.e. withhold funding from) Member States for not reaching a given level of ambition in their NECPs.

Such conditions exist in the current MFF in various forms and are also contained in the proposals for 2021-2027. Some of these include even a connection to the NECPs or climate action more generally. However, in Cohesion Policy, conditions are focused largely on compliance with the existing EU legislative acquis and not of a qualitative nature. In the CAP such qualitative conditions are well established practice, e.g., in the form of so-called Statutory Management Requirements (SMRs) and Good Agricultural and Environmental Conditions (GAECs). In practical implementation, however, specific thresholds would need to be defined, as discussed under option B.1 Incentives for higher ambition.

Taking these existing elements into account, the following specific sub-options have been identified that could directly and indirectly lead to higher climate ambition or additional actions:

- **Exclusion of fossil fuel projects**: Article 6 of the Cohesion Policy Funds Regulation defines the scope for funding and explicitly excludes fossil fuel-related projects (except for gas infrastructure). Having such an explicit scope exclusion is a new quality in Cohesion Policy. In principle, such general exclusions from funding could be broadened in application to the MFF as a whole and be included in the overall MFF regulation—and subsequently in the relevant individual instruments (including, for example, the CEF and InvestEU).
- **Ex ante conditions under Cohesion Policy**: Define a minimum level for a national renewable energy and/or energy efficiency target that must be met or surpassed to procure funding – to qualify the existing minimum condition that the NECP must be approved.
- **Restrict eligible interventions in Cohesion Policy**: Certain types of interventions could be removed from the list or be spelled out in more detail, signalling that certain activities are not eligible for funding or must meet minimum standards. For example, it currently includes intervention field 034, which is “high-efficiency co-generation, heating and cooling” (with a marker of 100% climate) and intervention 077 “alternative fuels infrastructure (also 100% climate marker). Such interventions could be qualified further as having to achieve at least certain minimum standards (like an specific efficiency improvement) or only be based on renewable sources.
- **Tighten CAP conditions:** The Commission proposal is already trying to implement tighter conditions in favour of more climate-friendly practices by expanding the cross-compliance requirements that all beneficiaries need to meet (e.g. by including new GAEC standards, previously considered especially “green”, such as maintenance of permanent pasture and crop rotation).

Merits of the options

Sticks and carrots can work well in combination—clearer conditions for stronger common standards coupled with the promise of higher funding allocation for going the extra mile form a robust incentive structure for climate action. Moreover, both incentive types could be implemented simultaneously using a staggered approach in which an initial set of conditions provides access to a share of the funding and an additional set opens up access to further funding. There is precedent for positive reinforcement in the CAP (e.g. additional greening payments)—but such an incentive-based approach has not yet been pursued in Cohesion Policy.

For the sectoral options incentives are equally valid—in Cohesion Policy the climate element already exists in the formula, which is an advantage—and the language requires clarification anyway. In the CAP, the principle is established at the beneficiary level and could be extended to apply to the national level as well, e.g., through a climate set-aside.

Incentives for higher ambition will be of particular interest at specific points in the EU climate policy-making process and therefore the option should be established now (e.g. through the creation of a sufficiently sizable (“Paris Agreement”) reserve). The “second linking window” (see section Introductory Background 2) should be of particular interest in this regard: the mid-term review in

Cohesion Policy, coupled with the review of the NECPs and the NDC for the EU, provides an opportunity for incentives for additional action. As a concept, this incentive for more climate action could then also be taken up in the negotiations on the MFF for 2028-2034, which would supposedly start around the same time (2025), to ensure continuity beyond 2027.

Use of more stringent conditions could improve climate proofing of the budget as a whole—and also help achieve the climate mainstreaming objective. Minimum standards to avoid investments in high emission projects that would counteract climate policy could and should be in place for all instruments.

Connection Type C: Rewards for high performance

Background: Rationale and opportunity

It is standard management procedure to use follow-up and progress monitoring to ensure that systems work as intended and objectives are met. The MFF has already a system in place to monitor performance and check on results—and the Commission has underlined its intention to further strengthen the MFF in this regard with its new proposals.

Performance in the context of the MFF and the link to the NECPs is in principle easily defined: good performance is dependent on the intended activities and their making a significant contribution to the NECPs objectives. On the other hand, bad performance means that the activities are not being carried out as planned and/or are not having the desired effect on emissions or energy production and consumption.

Regarding good performance, the key point to consider with regard to the NECPs is to create incentives that encourage and sustain effective practices. Historically, the early achievement of national objectives (such as renewable energy targets) has led to a roll-back of support policies in some Member States (e.g. Bulgaria or Spain). These regressive measures disrupted markets for clean technology and reduced further private investments in these sectors, stalling future deployment. Incentives for good performance in the MFF should seek to avoid similar cases happening in the future and reward early achievers. This also sends a signal of stability and lower risk of disruption to potential investors.

By definition, performance as understood in this context can only be measured over time. This type of connection between the MFF and the NECPs is, therefore, different than, for example, upfront strategy alignment, which takes place at the start of the process. That being said, the rules for progress measurement are established upfront and can send a signal that also influences the design of spending programmes.

Available options

Similar to the incentives for ambition outlined above, in terms of the different types of possible signals that can be sent to encourage linkages between MFF spending and the achievement of

climate and energy goals, both “carrots” and “sticks” can be deployed. For the purposes of this paper, they form the two main options under consideration:

- STICK: Penalties for low performance (coupled with a stringent monitoring system)
- CARROT: Reward (access to funding, better funding conditions) if monitoring reveals overachievement on climate targets

C. Option 7: Penalties for poor performance

Performance monitoring and the possibility of (poor) performance impacting future financing already exists in the current MFF. In fact, not meeting ex ante conditionalities, for example, can result in lower actual payments. In the proposals for a future CAP system based on SPs, the Commission also foresees action plans that incorporate specific progress indicators in case a Member State does not deliver on objectives laid forth in the SP (Article 39 CAP SPR).

Performance-related financial implications are thus in principle already established practice in the MFF. Under the CAP, which already presently implements a system of financial support connected to additional environmental action (e.g. the greening payments instrument), performance incentives are also linked to delivering the environmental benefits promised.

Avoiding poor performance is thus not specific to environmental or climate objectives, but an issue for the MFF and its instruments regardless of the objective. However, the system applied in Cohesion Policy and under the CAP in the current proposals (i.e. upfront plans with specific interventions and a performance monitoring system based on indicators) could well include climate-related elements or ways of improving the system for the purpose of inducing strong performance. Multiple approaches can be used to achieve this:

- Integration of **climate related indicators** into the catalogue for dedicated measurement under performance, for example, in reference to the national climate and energy targets—or sectoral targets (e.g. for agriculture under the CAP).
- Creating a **dedicated connection** between MFF-related performance monitoring and the **progress monitoring system for the Energy Union governance**, including the biannual progress reports and the possibility of country-specific recommendations stemming from this process. Both the CPR and the CAP SPR have existing references that open the door for this connection.
- Clear ex ante conditions (see also section B above) and reiterative **annual checks on the fulfilment of ex ante conditions** (not just at the outset).
- Clear rules on the **suspension of payments in the case of non-delivery** of objectives laid down in the Partnership Agreements or the CAP SPs (e.g. Article 39 CAP SPR), possibly with extra impact on climate-related goals or in direct connection to progress monitoring for the NECPs

C. Option 8: Rewarding good performance – avoiding policy roll-backs

While potential penalties are relatively well established under the MFF, incentives for overperformance are not easily found in the current proposals.[18] At a basic level, some reward exists in the form of receiving the financing as agreed upon (and not having a penalty applied). As specified in the introduction to this section, in the context of national energy and climate policy, a key function of offering rewards for good performance, or surpassing pre-determined objectives, could help sustain policies and avoid roll-back. Installing a reward for going beyond what had seemed realistic in the past would certainly help to create a positive, self-reinforcing dynamic in which governments are not concerned only about ticking the box on an EU commitment but focused on the benefit to their national economy.

There are several elements to be considered in creating an incentive for overperformance:

- Such a reward could be integrated into both the design of the CAP, and in Cohesion Policy financing (through the CPR). However, incentives following the same principle could also be included in centrally managed instruments such as the CEF.
- Rewards could manifest either as additional funding (such as a dedicated set-aside) or better conditions (such as additional access to guarantees from InvestEU).
- A “performance bonus” incentive could be enacted specifically for the **mid-term review** under Cohesion Policy, which marks a specific point in time when performance is reviewed to decide programming for the last two years (see also the Specific case IV: Mid-term review moment under Section B, Option 5).
- The timing of such a mechanism could also be **linked to the Energy Union governance** progress monitoring and be triggered specifically when an implementation gap is identified at EU level. By offering a reward for going beyond the national contribution to their renewable energy or efficiency goals, Member States could be incentivised to “overperform” deliberately and thus help fill the implementation gap that may have been created by underperformance elsewhere.
- Such a mechanism would need to **avoid creating a perverse incentive** to pledge low in order to make overperformance more likely, e.g., by setting minimum thresholds (as discussed under Section B, Option 5).

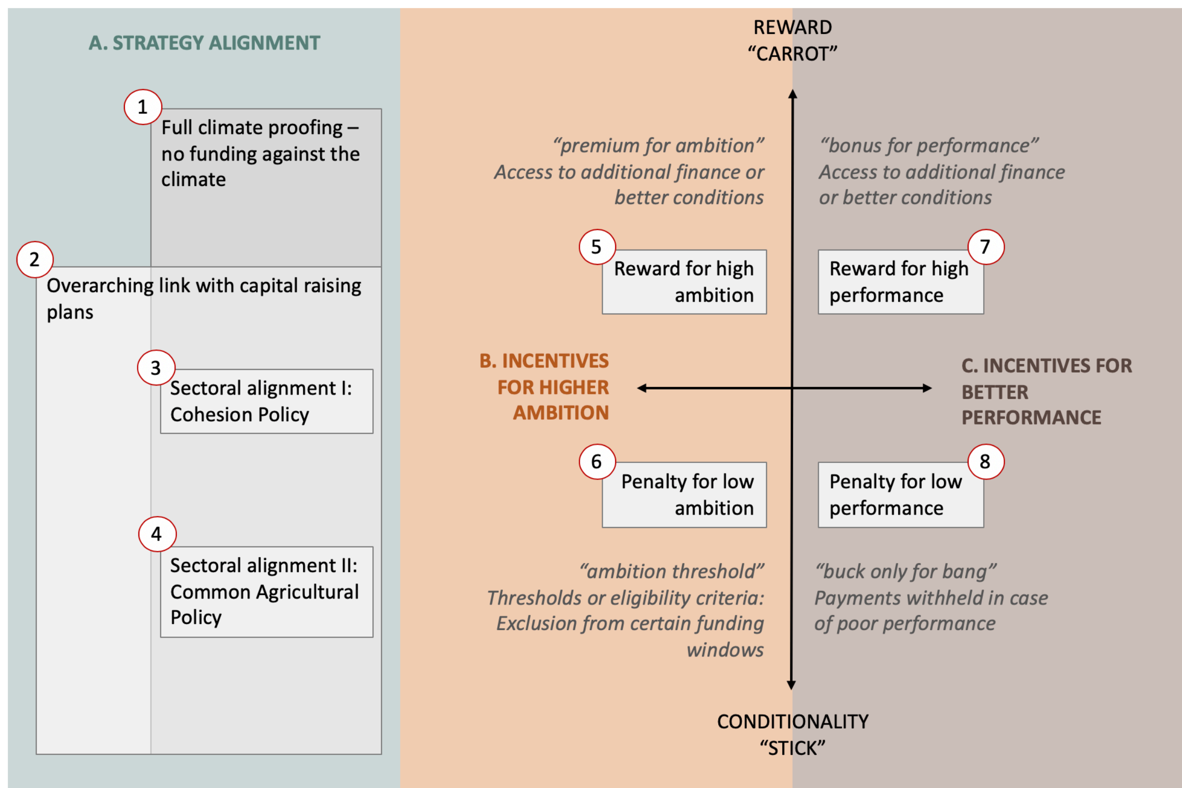
Merits of the options

A system for penalties on the basis of low performance exists in essence but could be more explicitly linked to climate and energy targets and the NECPs through small changes in the system for the CAP SPRs and the Cohesion Policy CPR. These include strengthening the respective conditions, integrating clear indicators and forming a link to the Governance Regulation’s progress monitoring system.

[18] The author would welcome pointers to relevant examples that may have escaped the research.

The performance rewards would represent a more innovative addition to the MFF toolbox but also require a source for additional finances or better conditions. However, the signal to private investors by this “policy disruption risk minimisation mechanism”, could be very beneficial for attracting financing in important projects and initiatives regarding national energy and climate policy.

Figure 5: Eight options for linking EU funding and national climate targets – along three types



Source: own visualisation © Ecologic Institute 2018

Summary and conclusions

The discussion of specific options for linking the future MFF and the NECPs uncovers a plethora of ways in which the current and proposed systems can be improved to direct more than only a small percentage of EU funding towards national energy and climate policy goals.

An overarching alignment of the two processes would be of particular value and could be achieved with relatively limited effort or legislation adjustment—especially if supported by political declarations calling for the budget to become "compatible with the Paris Agreement". A **full climate proofing** of the EU MFF (Option 1) may sound like a fundamental innovation, but it could be established through targeted measures like excluding projects and activities with highly averse climate impacts from funding. This has already been worked into the Regulation for the Cohesion Funds, which excludes fossil fuel projects and infrastructure almost entirely. Further analysis would be required to determine the impact of excluding other activities currently supported by EU funds, such as intensive agriculture.

Going through the exercise of **identifying investment needs** to draw up capital raising plans (Option 2) is also already included in both the MFF and NECP legislation but is not fully mandatory and much of the language remains vague. Moreover, in most cases, Member States lack this information and the timeline for drafting plans is tight. Thus, the concrete implementation of capital raising plans might have to be done in a stepwise fashion. On a more sectoral basis, additional opportunities exist for better overall alignment. In the regulations surrounding both Cohesion Policy and the CAP (Option 3 and 4), small changes in the draft legislation could greatly strengthen the link to NECPs in a way that identifies sector-specific investment needs and informs programming in both arenas (CAP and Cohesion). These modifications would furthermore strengthen the "added climate value" of the respective spending.

Many of the options detailed above **work well in combination**, and in fact, the overall **signal to stakeholders and investors would become even stronger** through the parallel implementation of individual elements, such as a higher climate mainstreaming target, a better system for accounting for climate action, the exclusion of high emission projects from funding scope and rewards for higher allocation or better performance. The doors that lead to a strong connection between EU funding and the NECPs are wide open on the basis of existing references in the text—especially for Cohesion Policy and through the new SP framework under the CAP, which include dedicated performance reviews and penalties for non-delivery. Additionally, the existence of a small climate component in the Cohesion Policy allocation formula could be used as a starting point for incentivising action.

One key question relating to the use of additional financial incentives is the source of the funding. Establishing a **"Paris Agreement Reserve" as a dedicated set-aside** to pull from for financial incentives for higher ambition, additional actions and good performance would send a clear signal to Member States that could influence both the drafting and implementation of NECPs. However, existing reserves could also be used to fulfil this function.