The EU Budget and Sustainability

Interim Analysis

April 2021

The 2021-27 EU Budget and Sustainability

Progress and Challenges

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1. INTRODUCTION

EU funded projects and programmes are perhaps the most visible contribution of the EU to the lives of European citizens. Whether it is about supporting student exchange in Europe — through the Erasmus Programme — energy efficiency investments in building, or payments to European farmers to meet higher environmental standards, EU spending is often seen as a positive contribution. However, wasteful spending in seemingly impractical projects, corruption, and harmful investments are also perceived by people with criticism not only towards the EU budget but to the functioning of the EU itself.

Most people — especially citizens of countries that are eligible for substantial funding through the EU — can easily enumerate great EU-funded projects, which responded to real community needs and resulted in substantial change for the greatest satisfaction of all stakeholders. It would doubtless be no problem for the same people to enlist just as many atrocious projects, where EU funding was spent on fabricated needs or served partial interests or in a wasteful way, while at the same time there was no financing available for urgent problems and regular costs. For many people, the way EU money has been spent shows a mixed picture, loaded with contradictions, sometimes bordering absurdity.

On the one hand, there is a broad support among citizens for the European integration, and the formation of a community of values and interests, and at the same time, for allocating substantive support (financial and other) to achieve common objectives concerning well-being, culture, solidarity, and a meaningful life. On the other hand, the multitude of useless and poor projects in the past EU budget cycles has pointed out frailties of the European and several national public law systems, as well as the weakness of democratic traditions and culture. Civil society has wide and far recorded In Europe, a certain narrative is gaining momentum – not only in net payer but also in certain net recipient countries – that member states would actually be better off without EU funding.

In December 2020, the European Council has adopted the regulation for the Multiannual Financial Framework (MFF), followed by the adoption of the Recovery and Resilience Facility (RRF) in February 2021 under Next Generation EU, an additional funding scheme to support the post-COVID recovery. Both the MFF and the RRF are meant to finance the ambitious sustainability and climate protection objectives of the EU and the European Green Deal laid out by Ursula von der Leyen's European Commission. The European Green Deal is highly ambitious: Europe should become a carbon-neutral continent, a world leader in circular economy, a frontrunner in biodiversity protection, and its agricultural and food strategy should be based on a "farm to fork" system based on local and short supply chains.

For this reason, it is a legitimate question whether EU financing reflects these ambitious goals and whether the spending is coherent. The aim of the following analysis will be to describe challenges observed in the 2014-20 MFF period and to provide a quick interim analysis of progress in the current cycle, taking into account the Recovery Facility. Because specific regulation of most EU funds is still being negotiated by EU institutions, the analysis relies on policy developments so far, indicating progress and remaining gaps based on current status.

2. PATTERNS OF (UN)SUSTAINABILITY: WHAT ARE THERE REMAINING AND IMPROVEMENTS IN KEY AREAS OF THE EU BUDGET?

The EU budget, even though constituting only about 1 % of the EU's Gross National Income (GNI) and 2 % of the public spending, is capable of catalysing major changes — positive or negative. If designed in a coherent and efficient way, EU transfers can contribute to building resilient and equitable societies and to the livelihoods and well-being of many. However, poorly designed programs result in wasteful, ineffective, or worse, harmful investments. All the while acknowledging the benefits well-executed projects, we have collected some of typical problem areas and failures of investment design in the 2014-2020 budget period and asses how they have been addressed in the 2021-27 MFF so far, as well as in the Recovery and Resilience Facility (RRF).

2.1. HARMFUL INVESTMENTS

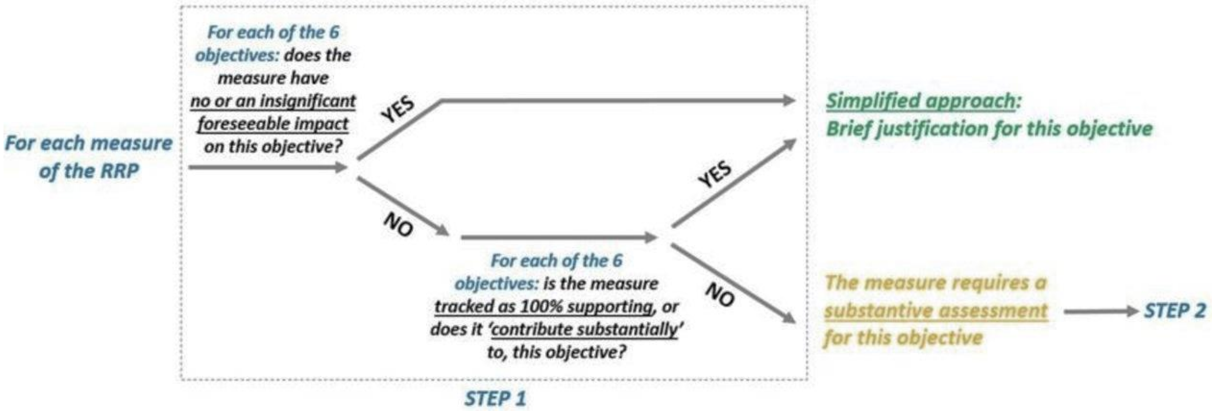
2.1.1. 2014-2020

While the purpose of EU investments is generally to contribute to development and public good in member states, projects have often been devised without considering the environmental damages caused by them. It has been quite common that no proper environmental assessment was conducted either before the approval of projects, or after they ended. In many cases, proper environmental assessments had been carried out, but their results were not considered during the final decision on the project. Examples include road construction and — to a lesser extent — airport development. In the previous budget cycle funding was often allocated to problematic project, like landfill sites instead of circular economy infrastructure. The indicators measuring the environmental efficiency of the projects and investments funded by EU money have been often inadequate.

Also, while the EU earmarks significant amounts for great climate protection projects (see next point), several funding options deliberately incentivized the use of fossil fuels, for example through the construction of gas infrastructure, the support of household coal burning, or through the construction of waste incineration plants, airport, or motorway constructions.

2.1.2. From 2021

The EU Taxonomy Regulation, in force since 12 July 2020, establishes a common language and provides a definition of environmentally sustainable economic activities as per European legislation.



If applied rigorously, the DNSH principle should ensure that EU spending is compatible with a nature-positive recovery — in other words, that no recovery measure puts ecosystems under undue pressure. The Commission's guidance outlines key principles and a two-step methodology for the assessment of 'do no significant harm' in the context of the RRF as a way to facilitate the work of Member States in the preparation of their recovery and resilience plans. Respecting the 'do no significant harm' principle is a precondition for the endorsement of the plans by the Commission and the Council and applies for all investments. The definition of sustainability includes social elements on top of environmental objectives.

The six environmental objectives identified for the purposes of the taxonomy are listed on Figure 1.

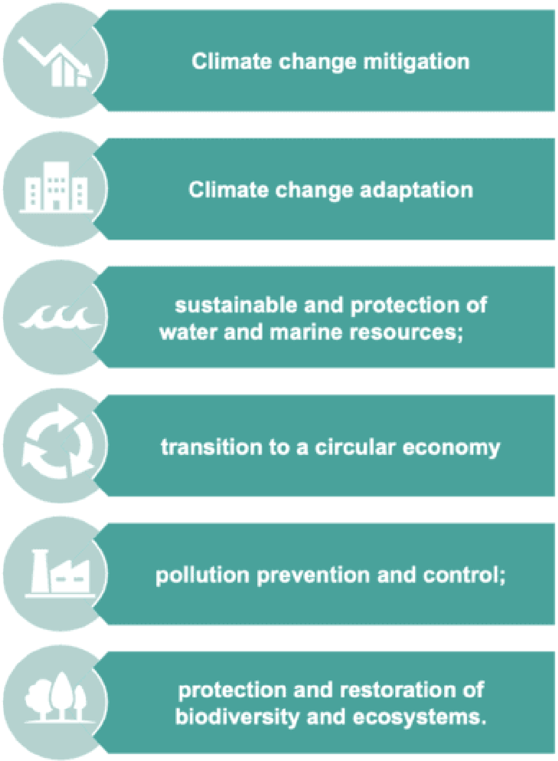


Figure 1. Six environmental objectives of the EU taxonomy.

For an economic activity to be considered taxonomy-compliant, it must

(1) Contribute substantially to one or more of the environmental objectives

(2) Do No Significant Harm to any other environmental objective and;

(3) Comply with minimum social safeguards[1].

However, the guidance leaves some significant loopholes. Gas is a grey area for the Commission. While fossil-fuel based power production and related infrastructure are excluded under the guidance, but it will be allowed where it is necessary to facilitate a transition to cleaner energy in coal-dependent countries. Trying to position gas as "bridge fuel," some countries are planning to use fossil gas to replace coal. This can have disastrous consequences for the climate and create further lock-in.

[1] Namely, the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the International Labour Organisation's ('ILO') declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions, and the International Bill of Human Rights.

3.1. INADEQUATE TRACKING METHODOLOGIES

3.1.1. Climate tracking

In the 2014-2020 MFF period, 20 % of EU costs was spent on objectives serving climate protection. In the 2021-27 MFF this coefficient was raised to 30 % and 37 % is required in the Recovery and Resilience Facility. While the 30 % climate earmarking is a welcome step forward from the Commission's original, pre-COVID, proposal of 25 % mechanisms for tracking climate expenditure in the 2014-20 period proved to be inadequate.

The Commission's methodology for identifying and measuring climate-related expenditure is based on the Rio Markers system developed by the OECD. This system relies on judgements of whether the expenditure is expected to have a "significant" or a "moderate" or no impact on the delivery of climate objectives. This meant that expenditure was often chalked up to the climate total even in cases where climate change had little or no relevance to the motivation behind the spending. This has likely resulted in a significant over-count of climate-related spending.

The methodology used in the Common Agricultural Policy (CAP) is particularly problematic as it too generously deems interventions within the scoring of the income support regime, and within rural development funding.

Successive reports, including the 2016 and 2020 reports of the European Court of Auditors have criticized the approach adopted for expenditure under the Common Agriculture Policy for granting climate contributions too generously. While CAP expenditure makes some contribution to climate, but mostly not and at a low level; Applying either the 100 % or the 40 % climate markers to the whole of the agricultural support budget (pillar 1 of the CAP) would mean a crude and inaccurate approximation, if not a serious overstating of the actual spending effects. Currently, around 20 % of the pillar 1 budget is assumed to contribute towards climate change (see the ECA 2016 report, p. 30,); but even this may be an over-estimate.

3.1.2. From 2021

The methodology used for the new budget period and the RRF has been updated to reflect definitions from the EU's sustainable finance taxonomy and the "do no significant harm" principle has been added marking an important improvement in approach. However, the methodology, while somewhat more nuanced, has remained broadly the same: spending expected to have a "significant" contribution to climate objectives being counted at 100 %, and spending with a "moderate" contribution counted at 40 % of its value.

The Commission has proposed a number of changes for the 2021-2027 period, including a wider range of intervention fields relevant to adaptation, new intervention fields for marine renewable energy investments and for alternative fuels infrastructure; and an increase from 40 % to 100 % in the markers applied to a range of rail and urban transport interventions, such as newly built railways.

The tracking of agricultural spending remains a major question mark, where the Commission has proposed a big increase in the percentage of income support and which is counted as contributing towards climate objectives, despite all the evidence stating the contrary.

3.1.3. Biodiversity tracking

While the 2014-20 MFF did not earmark a specific percentage of the Budget to be spent on biodiversity, tracking of biodiversity-related spending by the European Commission has started in 2015. Similar to climate tracking methodology, the Commission used the OECD Rio markers (significant (100 %), moderate (40 %) or insignificant (0 %) contribution) to track biodiversity-related spending. In case of biodiversity, the methodology suffers from the same weaknesses as the climate tracking methodology and the financing of contradictory objectives is an even greater problem. While biodiversity conservation receives some dedicated support mostly through the LIFE Programme, much more is spent on projects that undermine it: massive investments into grey infrastructure, road building leading to habitat fragmentation, expansion of grey areas and loss of green spaces (as evidenced by data from the European Environmental Agency). The contradictions are even worse in case of direct payments under the CAP. Area-based payments, by contributing to rent seeking, lead to an unsustainable farming system the effects of which are massive farmland biodiversity loss.

3.1.4. From 2021

In December 2020, the European Parliament, the Council, and the Commission concluded an agreement on budgetary discipline, cooperation on budgetary matters and sound financial management as well as on new own resources, including a roadmap towards the introduction of new own resources (IIA). The IIA was adopted in parallel to the Multiannual Financial Framework (MFF) Regulation and specified a biodiversity earmarking of 7,5 % from 2024 and 10 % for 2026 and 2027 under the MFF, while considering the existing overlaps between climate and biodiversity goals. This may be a significant increase, especially considering that the LIFE Programme does not even reach 1 % of the MFF. The biodiversity tracking methodology will be developed in 2021. The Commission has commissioned a study to update the tracking methodology and to assess funding required to implement the EU Biodiversity Strategy for 2030 and find remaining finance gap to current levels of funding. The Common Provisions Regulation, Cohesion Policy and other funding instruments will need to reflect these increased ambitions and set forth appropriate targets and specifications for biodiversity-related projects.

Box 1: The ill-devised agriculture subsidies
Agricultural spending that makes up almost a third of the EU's budget through direct (area-based) payments created a system of incentives, which primarily support export-oriented, intensive, highly polluting farming practices that are exhausting natural resources. The devastating effect of transfers only requesting a bare minimum of environmental conditions is underpinned by exhaustive research, including by several consecutive assessments of the European Court of Auditors. Data shows that in Europe since 1980 the population of farmland bird species has decreased in the EU by 55 per cent; the number of butterflies, honey bees, and other wild pollinators responsible for 80 per cent of pollination is in dramatic decline. European agriculture itself contributes by 10 per cent to greenhouse gas emissions, although it could easily be its moderating tool. The Common Agricultural Policy (CAP) has pushed farmers to specialize in a reduced number of crops which heavily depend on chemical inputs. Furthermore, livestock breeding in the EU is still determined by an industrial character keeping the animals under adverse conditions, while European meat consumption exceeds the nutrient needs of the continent's population. The CAP clearly contradicts the nature conservation objectives also set as EU goals and undermines the efforts to ensure services provided by nature, such as clean water, pollination, biodiversity conservation, landscape, and natural protection against diseases. In the meantime, the EU allocates financial resources also for nature conservation objectives, among other things for maintaining the Natura 2000 site network. Thus, the same system both generates problems and tries to solve them: indicators for biodiversity and natural capital generally show such mitigation has very limited success.

The social effect of agricultural support is likewise extremely bad: direct payments incentivize "rent-seeking" behaviour as it is defined in economics. Large-scale farms and agro-industrial conglomerates receive the biggest share of funding, 85 per cent of resources go to large farms (upper 25 per cent). This system of flawed incentives results in increasing land concentration and the depopulation of the countryside: between 2005 and 2016, the number of farms decreased by 25 per cent (!) in Europe, and their overwhelming majority was small farms (85 per cent). Again, neither rural development nor social funds can compensate for this phenomenon. EU agricultural subsidies, promoting an export-oriented agricultural model which relies on the overuse and depletion of our natural resources, while at the same time relying on the import of feed at low cost, generates serious negative impacts on natural resources well beyond European territories.

4.1. INCENTIVES FOR SOLUTIONS THAT PROMOTE SYSTEMIC CHANGE

Although the EU budget would mean a particularly well-suited tool to support a move away from coal and huge, centralized energy systems, for example by helping local community-based renewable energy projects, in the 2014-20 period there was no adequate regulatory framework for programs aiming to democratize the energy sector. Neither the regulatory framework, nor the incentives under funding programs like Cohesion Fund were in place to assist local renewable energy communities in organizing collectively their local energy supply.

Energy communities represent a cost-efficient and empowering form of energy service that provides direct benefits to citizens by advancing energy efficiency and lowering electricity bills and contributing of local self-sufficiency, a sense of ownership and control over local resources.

4.1.1. From 2021

In 2019 the EU has adopted the Clean energy for all Europeans package and new rules that enable active consumer participation, individually or through citizen energy communities, in all markets, either by generating, consuming, sharing or selling electricity, or by providing flexibility services through demand-response and storage.

While the European Regional Development Fund and Cohesion Fund regulation (under negotiation) indicate such projects under output and result indicators, current EU Budget regulation leaves it too much to the discretion of Member States.

5.1. FRAUD AND CORRUPTION

Corruption related to EU funding has been widespread. EU funds in several countries, have contributed to weakening institutional quality in terms of wasteful public spending and increased 'legal' corruption conducted through public procurement. EU funding impacts institutionalized grand corruption in CEE first, by providing additional public resources available for corrupt rent extraction; second, by increasing the controls of corruption for the additionally allocated funding. Radical improvement of the monitoring and controlling framework is needed to avoid state capture and reinstate accountability over spending.

5.1.1. From 2021

The European Union parliament and the member states agreed in November 2020 that access to funding under the new MFF would be tied to the Rule of Law mechanism. The aim is to protect the EU budget against breaches of the principles of the rule of law in a member state affecting or seriously risk affecting "the sound financial management of the EU budget or the protection of the financial interests of the EU in a sufficiently direct way." Sanctions may be imposed on EU countries that fail to apply the rule of law.

Under the agreement, the European Commission, the EU's executive arm responsible for ensuring bloc-wide laws, would first have to establish whether any fundamental principles have been violated.

The key element of the process is that the financial interests of the EU must be affected "in a sufficiently direct way." This means that it is not enough that the Commission and a qualified majority of member states think there are breaches of the principles of the rule of law, they must also prove that these breaches directly affect the financial interests of the EU.

But the EU itself is also subject to the rule of law. It can only cut the funding to all of a member state's beneficiaries if there is a concrete Treaty-based procedure to do so. The only legal base that can justify the Regulation that has just been adopted is the need to protect the financial interests of the Union itself. This is why the 'rule of law' regulation is directly linked to the need to protect the financial interests of the Union, not to the value of the rule of law itself. Some parts of this Regulation adopt a very wide view of the principles underlying the rule of law. But Article 3 of the Regulation stipulates clearly that measures can only be imposed if there is a clear link to the financial interests of the Union:

In practice, this will be difficult to establish. When a government tries to gain more influence over the appointment of judges and their careers, its aim is mostly not to defraud the EU, but to use the judiciary for internal political purposes. The causal link between the erosion of the rule of law and a danger for the EU's financial interests will in most cases be tenuous and difficult to uphold in court. In practice it could well be the case that an illiberal regime represents less of a danger to the financial interests of the EU than a country in which the judiciary is completely independent, but inefficient. The misuse of EU funds could very well be more prevalent in southern Italy or Bulgaria than in Poland or Hungary. It was a mistake to frame this Regulation as being directed against two countries in particular.

6.1. PUBLIC PARTICIPATION

Public participation suffered from a number of weaknesses in the previous 7-year period. On the one hand, in the 2014-2020 programming period, the partnership principle was strengthened in the whole budget cycle and was given proper guidance with the issuance of the European Code of Conduct on Partnership (ECCP) in 2015. However, despite the proper written guidance of how to integrate partnership into all stages and aspects of programming, the ECCP was implemented only partially or not at all. The reasons behind this vary but can be categorized as follows:

- authorities often did not provide sufficient information to stakeholders
- CSOs often lacked capacity to study and analyse enormous amounts of documents, and to make appropriate proposals. Financial support for capacity was a general deficiency.
- In the monitoring committees, government representatives often outnumbered social partners.
- Often there were no opportunities for local communities to give an opinion on projects that directly affected them, or comments were not considered.
- It was often unclear for social partners what happened with the submitted public opinions on project proposals.

6.1.1. From 2021

6.1.1.1. Public Participation in the RRF

In the RRF, there is no obligation to engage with relevant stakeholders, including CSOs, in the preparation, implementation and monitoring of the National Recovery and Resilience Plans (NRRPs). The Guidance note issued by the European Commission in September 2020 on the preparation of NRRPs invites Member States to publish their Plans and engage with the public. It asks Member States to detail the processes and structures whereby complementarity and coordination of the management of various Union sources of funding are ensured. Moreover, it calls on countries to describe consultation and contribution of social partners, civil society and other relevant stakeholders, in the drafting and implementation of the recovery and resilience Plan. Although this is positive, the Guidance note cannot set any legal obligations on Member States.

Two other flaws that can be identified in the Commission's proposal for regulation are the absence of any references to the partnership principle enshrined in the Common Provision Regulation laying down the common rules to the European Structural and Investment Funds (ESIF) and to the European Code of Conduct on Partnership, as well as of a provision clearly identifying which actors can be implementing actors of the RRF funds.

As Civil Society Europe has concluded based on responses from 17+ countries, stakeholders faced a number of obstacles to having their voices heard in the planning of post-COVID recovery spending. Only in a handful of countries was civil society properly involved in the process. The main obstacles experienced were 1) poor quality consultations, 2) failure to use existing consultation structures, 3) uncertain procedures, and 4) late-stage consultations.

Table 2: Level of involvement of CSOs in preparation of NRRPs

<table>
<tr><th>Options</th><th>No of Responses</th><th>Options</th><th>No of Responses</th></tr>
<tr><td>Well structured</td><td>1</td><td>Tick-boxing exercise</td><td>9</td></tr>
<tr><td>Transparent</td><td>1</td><td>Too limited</td><td>18</td></tr>
<tr><td>Participatory</td><td>3</td><td rowspan="2">No opinion</td><td rowspan="2">5</td></tr>
<tr><td>Non-transparent</td><td>22</td></tr>
</table>

Figure 2. Source: CIVIL SOCIETY EUROPE.

	PROGRESS	AREA OF CONCERN
Harmful investments	Legal safeguards in place	Loopholes for gas infrastructure
Climate tracking	More nuanced methodology	Sticks to the Rio Markers system tracking of agricultural spending remains a major question mark.
Biodiversity tracking	Updated methodology will be introduced	Not integrated into the current programming
Projects for systemic change: energy communities	Definitions and regulation in place	Not enough incentives outlined yet
Fraud and corruption	Rule of law regulation in place	Cannot address deficiencies that cannot be proven to directly affect the EU's financial interests.
Public participation	----	Very weak public consultations for RRF

ANNEX: SUSTAINABILITY-PROOFING CRITERIA

Sustainability proofing is a **methodological approach in the EU budget planning and implementation**, and different substantive, procedural and institutional proofing tools can make it happen. In this novel approach, sustainability is the continuous adaptation to the changing natural and socio-economic environment, where the goal is increasing human well-being, the economy is a tool, and the natural environment is a precondition. Thus, protecting the environment and maintaining the ecosystem services is not a luxury, but essential precondition for a thriving society and economy. On the other hand, economy has to be rather perceived as the means to achieve societal objectives. Sustainability proofing also fully considers the mitigation hierarchy: focusing on preventing problems and decreasing trade-offs with the help of mitigation measures if needed and using compensation measures as the last resort.

Suggested measures for sustainability proofing the next MFF Sustainability proofing for the next MFF should provide an innovative approach in the planning and implementation with a view to putting sustainability at the heart of the MFF and serve the implementation of the Sustainable Development Goals. Sustainability proofing is thus a tool to ensure that environmental integrity is maintained as a precondition for any development, while economic and social development serve the objective of increasing human well-being. It is a stepwise process with the application of targeted substantive, procedural and institutional measures to increase policy coherence both in the policy and implementation cycles in internal and external funding. It builds on the streamlined application of a simple set of existing and improved tools within the MFF governance framework, which can significantly increase policy coherence and the efficiency of EU funding.

THE EIGHT PRINCIPLES

1

The EU budget should **work for the people and with the people,** with greater transparency and accountability, respectful of diversity and meaningful participation of the citizens.

2

The EU budget should **strengthen the common European values,** in Europe and globally.

3

The EU budget should increase wellbeing and contribute to **decreasing inequality** and social exclusion at all scales.

4

The EU budget needs to take holistic approach, **support systems change** and promote innovation, which is required for the transition to sustainability and building a circular economy.

5

The EU budget has to serve the development of a **diversified and resilient economy and society,** where the full potential and participation of all communities, organisations and businesses of any size is fully achieved.

6

The EU budget should serve the **public good.**

7

The EU budget should contribute to **decreasing the total environmental pressures** (use of natural resources, use of land and emissions of waste, toxic substances, greenhouse gases and alien genotypes), and should not contribute to shifting of environmental pressures in time and space.

8

The EU budget should contribute to improving the **state of environment and** maintaining and restoring **ecosystem services**, which is the very foundation of our society and economy.