

Europe's Economic Recovery – How can the Recovery and Resilience Facility support achieving climate neutrality?

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Key messages

In July 2020, the European Council agreed on an unprecedented EU recovery package – dubbed Next Generation EU. This agreement contains elements that will advance EU climate policies. However, if it is to pave the way to climate neutrality by 2050, it needs to improve. To support achieving climate neutrality by 2050, the EU recovery package should (1) allocate around 40 % of funding to the transition towards climate neutrality, (2) link its climate spending target to the EU Taxonomy Regulation, (3) establish a solid framework to make sure that EU expenditures only support investments that are compatible with the 2050 climate neutrality objective, (4) enable Member States to spend recovery funds for climate protection by granting them more time to implement investments, and (5) establish an institutional set up for the distribution of recovery funds that supports climate policies, ensures democratic legitimacy and allows swift payment.

About this paper

This paper is part of the project “Building bridges — High Trust Network with Conservative Groups for Ambitious Climate Action”, funded by the European Climate Initiative (EUKI).¹ The project aims at facilitating dialogues on climate policies between conservative and other groups from Hungary, Poland and Germany.

To avoid the most severe impacts of dangerous climate change, immediate and drastic cuts in global greenhouse gas emissions are indispensable.² In the face of rapidly shrinking emission budgets³ **this decade is crucial for halting dangerous climate change**, possibly offering a last chance to limit temperature increases well below 2°C or 1.5°C.⁴ There is the danger that emission

¹ Opinions expressed in this paper represent the views of the authors and do not necessarily represent the position of the European Climate Initiative. For further information, please contact nils.meyer-ohlendorf@ecologic.eu.

² UNEP estimated that if serious global emission reductions to meet the projected emission levels for the 2°C and 1.5°C would only have been 0.7 % and 3.3 % annually if serious emission reductions had begun in 2010. As this did not happen, required annual reductions increased drastically to 2.7 % in 2020 for the 2°C goal and 7.6 % on average for the 1.5°C goal. UNEP Gap Report 2019.

³ In its in-depth analysis in support of the commission communication on a ‘Clean Planet for all’ of 28 November 2018, the Commission indicates that a 1.5°C compatible EU-28 carbon budget for 2018-2050 would amount to 48 Gt CO₂.

⁴ IPCC, Mitigation Pathways Compatible with 1.5°C in the Context of Sustainable Development

will rebound once the Corona crisis is over – similar to what happened after the financial crisis of 2009.⁵

On 21 July 2020, the **European Council reached agreement on a recovery package** worth € 750 billion and the next multiannual financial framework (MFF) of € 1074 billion. A Recovery and Resilience Facility (RRF) worth € 672,5 billion will be the center piece of the EU's recovery efforts. The European Council agreed – as a general principle – that all EU expenditure should be consistent with Paris Agreement objectives and should do no environmental harm. More specifically, EU expenditure must comply with the objective of EU climate neutrality by 2050 and should contribute to achieving the EU's new 2030 climate targets, which will be updated by the end of 2020. The European Council also agreed on an overall climate spending target of 30% to the total amount of expenditure from the MFF and recovery programs.

These are important decisions but **alone they will not reduce EU greenhouse gas emissions**. In order to avoid a post-crisis rise in emissions thus failing to reach short and long term climate targets, **negotiations of the EU's recovery package should take the following into account**:

- Allocate sufficient funding for the transition towards climate neutrality,
- Include robust, scientifically backed and transparent criteria that help reach the new climate spending target,
- Ensure any EU expenditures do not cause environmental harm, i.e. the EU should not support investments that are incompatible with the Paris Agreement and the 2050 climate neutrality objective,
- Enable Member States to spend recovery funds for climate protection according to their needs,
- Establish an institutional set up for the distribution of recovery funds that supports climate policies without creating unnecessary burdens.

Recovery and Resilience Facility for climate neutrality – is it sufficient?

The European Council wants to invest 30% of the new MFF and 30 % of recovery funding into decarbonizing Europe's economy, an increase of 5 percentage points compared to the Commission's initial proposal. This could trigger climate investments of € 322 billion under the next MFF 2021 and 2027 as well as € 225 billion under the EU recovery programs. Within the recovery programs, the RRF would provide the lion's share of climate spending – up to € 93 billion in grants and € 108 billion in loans between 2021 and 2023. Combined, the new MFF and the recovery program could lead to climate investments worth € 547 billion between 2021 and 2027. According to the Commission, the new MFF and the recovery package could leverage an overall investment of €3,100 billion.⁶

⁵ In the wake of the 2009 financial crisis, global greenhouse gases fell by 400 million tonnes but rebounded by 1.7 billion tonnes in 2010, the sharpest upswing in history. The EU saw a similar pattern but much less pronounced.

⁶ https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/1_en_act_part1_v9.pdf

The Commission has estimated that **achieving the current 2030 climate and energy targets will require additional investment** of €260 billion annually.⁷ Other estimates assume investment needs for achieving the current 2030 reduction target of € 175 to € 349 billion per year.⁸ Higher 2030 target would increase investment needs. According to *Bruegel*, a think tank, a higher 2030 reduction target of around 50 – 55 % would require additional investments of around € 300 billion annually.⁹

These estimates suggest a **significant investment gap**, possibly in the range of more than € 1600 billion for the next MFF period¹⁰ or € 2000 bn for the next decade.¹¹ To close those gaps, *Agora Energiewende* proposes investments of 40 % into climate action.¹² It is noteworthy that – according to a HSBC Research Group study – the EU's 2009 recovery package featured a green share of a staggering 60%.¹³

However, **these estimates should be treated with caution**. First, the MFF and the EU recovery packages are only one source of funding. Other sources include national budgets and – more importantly – private sectors. Second, estimated investment gaps are not nearly as clear cut as they appear. Estimates depend on a number of assumptions – such as forecasts of GDP and population growth, cost developments of technologies, and – crucially – regulatory choices. Depending on the choice of assumptions, estimates of investment needs vary greatly. For example, *Agora Energiewende* estimates that the new EU budget could cover as much as 33 % of required investments or as little as 3 %.¹⁴

How to implement the climate spending target?

The implementation of EU climate spending targets is a challenge – for political and methodological reasons. A recent report from **the EU Court of Auditors showed that the 2020 climate spending target of 20% was not achieved**.¹⁵ The Court also reported that the Commission had overestimated the spending for climate policies, in particular in the EU's agricultural policy.

To improve the current framework, the new climate spending target **should directly be linked to the EU taxonomy regulation**. The EU taxonomy regulation contains criteria to qualify an economic activity as environmentally sustainable¹⁶ and empowers the Commission to specify these activities in further detail, which could entail, for example, **detailed lists of eligible activities**. The European Council made no reference to the EU taxonomy regulation. It only agreed to adopt “reliable criteria

⁷ https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf

⁸ <https://www.bruegel.org/2020/01/a-trillion-reasons-to-scrutinise-the-green-deal-investment-plan/>

⁹ <https://www.bruegel.org/2020/01/a-trillion-reasons-to-scrutinise-the-green-deal-investment-plan/>

¹⁰ Agora Energiewende: Recovering Better, June 2020

¹¹ <https://www.bruegel.org/2020/01/a-trillion-reasons-to-scrutinise-the-green-deal-investment-plan/>

¹² Agora Energiewende: Recovering Better, June 2020

¹³ https://www.globaldashboard.org/wp-content/uploads/2009/HSBC_Green_New_Deal.pdf

¹⁴ Agora Energiewende: Recovering Better, June 2020

¹⁵ European Court of Auditors, Review 01/2020: Tracking climate spending in the EU budget

¹⁶ According to Article 4: an economic activity qualifies if it “contributes substantially to one or more of the environmental objectives of the Regulation”, which include climate mitigation. This is the case “where that activity contributes substantially to the stabilisation of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system consistent with the long-term temperature goal of the Paris Agreement through the avoidance or reduction of greenhouse gas emissions or the increase of greenhouse gas removals”. The Regulation also lists of a number of activities that qualify.

for classifying such expenditure”, called for an “effective methodology” for monitoring climate-spending, and requested an annual report from the Commission on climate expenditures.

How to avoid that the Recovery and Resilience Facility causes environmental harm?

According to the European Council, **EU expenditure should be consistent with the "do no harm" principle of the European Green Deal**. This is an important element of the Council's agreement. The principle, however, is vague, and the European Green Deal does not specify it. The Commission's European Green Deal communication only states that EU initiatives “should live up to a green oath to ‘do no harm’”.¹⁷

To make the no harm principle effective, the **EU recovery package should be built on clear criteria**, some of them already enshrined in EU law:

- **Clear link to criteria under the Just Transition Fund:** According to Article 5 of the proposed Regulation on the Just Transition Fund (JTF), the JTF may not support “*investments related to the production, processing, distribution, storage or combustion of fossil fuels*”. Applying these requirements, the RRF should explicitly not fund investments in any type of coal, oil and gas infrastructures (unless funding is aimed at adapting existing natural gas transmission infrastructure to transmission of hydrogen). To this end, the RRF should contain negative lists of ineligible investments.
- **Clear link to EU Taxonomy Regulation:** Article 17.1 of the EU Taxonomy Regulation considers an activity as significantly harmful “if it “leads to significant greenhouse gas emissions”.¹⁸ This definition is vague but the Regulation specifies it through its reference to the temperature goal of the Paris Agreement.¹⁹ In consequence, RRF funding should not be eligible for investments that are incompatible with the Paris Agreement and 2050 climate neutrality objectives.
- **Clear link to EU climate targets:** Funding decisions should clearly be linked to achieving the EU’s 2030 and 2050 climate targets, in line with a quantified EU’s fair share in remaining global emission budgets. The European Council proposed stronger language to this end than the Commission.
- **Equal treatment of the aspect of green transition:** According to the European Council, country-specific recommendations under the European Semester as well as growth potential, job creation and economic and social resilience of the Member State score *highest* in the Commission’s assessment of RRPAs. Effective contribution to the green transition is also a prerequisite for positive assessment by the Commission. In comparison

¹⁷ The communication only states that explanatory memoranda accompanying legislative proposals and delegated acts will explain how to uphold the do no harm principle.

¹⁸ Article 2(17) of the Regulation on sustainability-related disclosures in the financial services sector contains a similar definition, stating that investments shall not ‘significantly harm’ environmental objectives ‘as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy’.

¹⁹ Article 2 (5), for example, stipulates that “climate change mitigation” means the process of holding the increase in the global average temperature to well below 2 °C and pursuing efforts to limit it to 1,5 °C above pre-industrial levels, as laid down in the Paris Agreement”.

to the Commission's proposal, this is a step backward. The Commission explicitly gives priority to the "green transition". There is a need for equal treatment of this important aspect in the implementation of the RRF.

Can Member States absorb the money: How to ensure useful spending?

The European Council suggests that 70 % of the grants provided by the RRF are committed in the years 2021 and 2022, the remaining 30% by the end of 2023. It is the very purpose of stimulus packages to spend money quickly but spending the very large RRF funds usefully within three years is a challenge – in particular for investments in projects as complex as climate mitigation. To ensure quick and useful spending, negotiations²⁰ should take account of these features:

- **Four year interval:** Many meaningful, forward looking and long lasting investments in climate protection take time and should be well prepared not to waste time and opportunity. Planning, consultation and approvals can only be accelerated to a limited extent. The Commission has proposed that the construction plans have a four-year timeframe. This is a more sensible timeframe.
- **Aligning national planning:** Member States will adopt recovery and resilience plans (RRPs) in the context of a number of other plans and processes: (1) National Reform Programmes under the European Semester, (2) national energy and climate plans under the Regulation on the Governance of the Energy Union, (3) partnership agreements and operational programmes under EU funds, and (4) – once enshrined in EU law – territorial just transition plans under the JTF.²¹ RRP are annexed to National Reform Programmes. These planning processes must fully take into account climate related aspects, while reducing administrative burden on Member States. To that end, the number of plans should be kept at a manageable level. It should be considered how the elements of the newly proposed plans could be further integrated into already existing planning processes addressing the above-mentioned goals.
- **Ensuring useful spending:** To stem the economic crisis, Member States will rush to spend recovery funds but this should not lead to wasting public money. To address this risk, spending criteria need to be concrete, enforceable and a solid basis for the Commission's assessment – as suggested above.

Distributing RRF funds – institutional setting to support climate action

The **Commission proposes** that the distribution of RRF funds builds on the **European Semester**. According to the Commission's proposal, Member States prepare so-called recovery and resilience plans (RRP) which set out reform and investment agendas for 2021 – 2024. The Commission assesses the RRP based on the criteria established by the regulation and on a rating system

²⁰ Note that the European Council had invited the Commission to come forward before the October European Council with proposals on how to accelerate and facilitate procedures in Member States.

²¹ Article 14.2 of the Commission's proposal.

established in the annex. Both – criteria and annex – give the Commission wide discretion. Following its assessment, the Commission takes a decision on the RRP. Importantly, this decision is an implementing act, adopted in accordance with the so-called examination procedure. According to this procedure, Member States can block the Commission's decision with qualified majority. Once the RRPs are approved, Member States request payments as soon as it has reached milestones outlined in the RRPs. The Commission decides whether milestones have been reached or not.

The **European Council agreed with many elements of this proposal but requires some important changes.**

- **Council approval of plans:** According to the European Council, the Council of Minister approves the Commission's assessment of the RRP by qualified majority, on the basis of a Commission proposal. In contrast to the Commission's proposal, Council has not only a veto but must approve the Commission's assessment of RRPs.
- **Opinion of the Economic and Financial Committee:** Pursuant the European Council, the Commission approves payments only following an opinion by the Economic and Financial Committee on the "satisfactory fulfilment of the relevant milestones and targets".
- **Referral to the European Council:** As another important change, a Member State can refer RRPs to the European Council if – in exceptional cases – it considers that there are "serious deviations from the fulfilment of the relevant milestones and targets". In this case, the Commission cannot approve funding, suspending payment for up to three months.

In principle, the proposed system **serves the objective to make funds available as quickly as possible, while ensuring national ownership, pursuing common European objectives and meaningful Commission oversight.** With its mechanism to assess RRPs and possibly suspend payments, it addresses the ineffectiveness of the European Semester.²² However, the proposed system would benefit from these changes:

- **Engaging climate policies:** The European Council wants the Council of Ministers to approve the Commission's assessment of the RRPs, effectively Ministers of Finance. In addition, the European Council suggests that the EU Economic and Financial Committee issues an opinion on the implementation of the RRPs. This Committee is composed of senior officials from national administrations – mostly Ministries of Finance and national central banks –, the European Central Bank and the Commission. As a result, RRP assessment takes place primarily from the perspective of financial and economic policy. Although financial and economic policy and climate protection converge often, this system would lack a strong climate policy voice.
- **Involving the European Parliament:** If adopted as proposed, RRF funds would be spent in a bilateral dialogue between the Commission and national governments – Member

²² The implementation of country specific recommendations – the core of the European Semester – is not good and the trend has worsened in the last few years. Member States have been reluctant to properly scrutinize their peers. For this reason, the European Semester process alone would be inadequate to ensure that recovery are spent properly, embezzlement is prevented and corruption checked. <https://www.bruegel.org/2018/06/is-the-european-semester-effective-and-useful/>

States submit RRP^s, the Commission assesses and Council approves the Commission assessment. Member States can suspend payments by referring specific RRP^s to the European Council. The European Parliament would have no distinct role in the process.²³ There is an ongoing lively debate on the necessity of involving the European Parliament among the conservative groups. Some say that this would introduce an unnecessary burden into the process by increasing its complexity and by introducing possibly inadequate political aspects into the approval. Whereas others state that given the enormous amounts of spending and its many corresponding political choices, the European Parliament – the only directly elected EU institution – should have a bigger say in the process.

There are at least two **options how to involve the European Parliament**.

- **Delegated act:** The Commission could assess the RRP^s through delegated act, not with implementing acts as envisaged by the European Council and Commission. In this system, the European Parliament could be empowered to veto the approval of RRP^s. This option would enhance democratic legitimacy of RRF funding but it should not slow down the distribution of recovery payments, possibly weakening the EU's economic recovery. Tight deadlines for deliberation, limiting the veto to specific cases and / or qualifying the effects of a veto could be options to strike a balance between enhancing democratic legitimacy on the one hand and to ensuring swift payment on the other.
- **Referral to the European Council:** The European Parliament could be entitled to request the European Council to examine the RRP of individual Member States with the effect of suspending payments. This option is inspired by the proposal of the European Council to allow Member States to refer RRP^s to the European Council, giving the European Parliament the same powers that individual Member States would have.

²³ <https://www.delorscentre.eu/en/publications/detail/publication/how-to-spend-it-right-a-more-democratic-governance-for-the-eu-recovery-and-resilience-facility>