

## Aligning EU budget expenditures with the objectives of the Paris Agreement

Recommendations for sound and consistent Climate Proofing of the Multiannual Financial Framework 2021–2027

For: European Climate Foundation



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Project number: 208082  
May 2019

This report was written between February and May 2019. The research herein is based on publicly available information and on the status of ongoing negotiations until this date.

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## LIST OF ABBREVIATIONS

CAP	Common Agricultural Policy
CBA	Cost-Benefit Analysis
CEF	Connecting Europe Facility
CF	Cohesion Fund
CO <sub>2</sub>	Carbon Dioxide
CPR	Common Provision Regulation
EC	European Commission
EIA	Environmental Impact Assessment
EIB	European Investment Bank
EPS	Emission Performance Standard
ERDF	European Regional Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
EU	European Union
GHG	Greenhouse gas
IPA III	Instrument for pre-Accession
JASPER	Joint Assistance to Support Projects in European Regions
MFF	Multiannual Financial Framework
NDICI	Neighbourhood, Development and International Cooperation Instrument
NECP	National Energy and Climate Plan
OCTP	Council Decision on the association of Overseas countries and territories establishing the funding in form of a Programme
SEA	Strategic Environment Assessment
SME	Small-medium enterprise

SUMMARY

The next EU long-term budget aims to invest €1.3 trillion across a range of sectors in all Member States over the period 2021-2027. In view of the EU's 2030 emission reduction target and its strategic long-term vision for a climate-neutral economy by 2050 it is crucial to set the next Multiannual Financial Framework on a zero-carbon pathway. It is not only necessary to earmark a minimum share of the budget for climate-relevant spending, as ensured by the proposed **25% climate mainstreaming target**. It is equally important to **climate proof the entire budget**, i.e. to prioritise energy efficiency measures, to consider specific decarbonisation pathways and to ensure that infrastructure is resilient to climate change impacts. Effectively climate proofing the entire budget would enable the implementation of better and more climate-friendly solutions to help achieve the EU's climate targets.

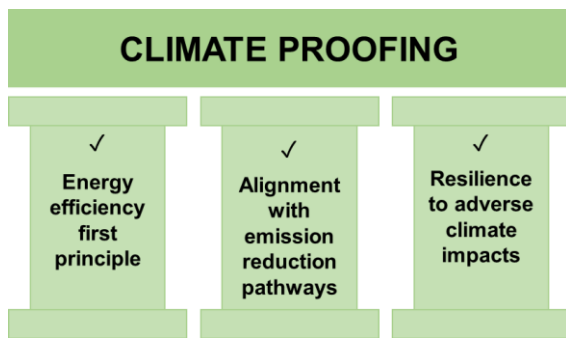


Figure 1: Climate proofing concept definition

This report provides recommendations on **clear definitions and methodologies** for the implementation of a mitigation-focused climate proofing concept. They are based on a review of current approaches under the EU budget and regulations and of the European Investment Bank that include elements of climate change adaptation and mitigation considerations during programme/ project development and appraisal.

Our research finds that in the EU budget proposals **climate proofing is neither explicitly defined nor consistently applied**. As a consequence, these

approaches may not exclusively direct investments towards sustainable infrastructure and fully align the EU budget with the Paris Agreement. The analysis also reviews regulation proposals by the European Commission for infrastructure funds and programmes under the next EU budget. While the extent to which the proposals define the climate proofing concept and methodology differs across proposals, **a clear and consistent framework is missing**. Amendments proposed by the European Parliament for the European Structural and Investment Funds could facilitate an effective climate proofing approach and serve as a methodological basis for all infrastructure related EU funds.

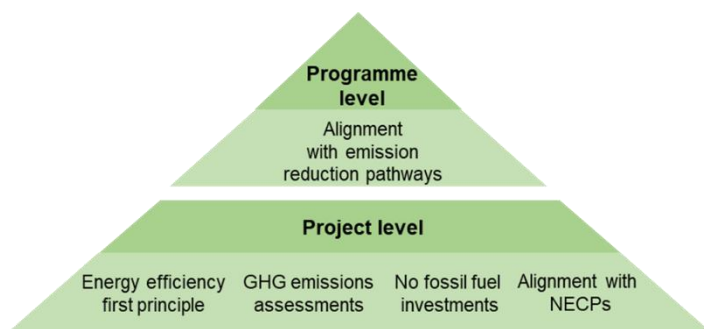


Figure 2: Mitigation-focused climate proofing hierarchy

In this paper we propose to establish a mitigation-focused **climate proofing hierarchy** which would cover both the programme as well as the project level. At **programme level**, programme documents such as Partnership Agreements, Operational Programmes, or Strategic Plans of the Common Agricultural Policy (CAP) need to systematically take into account sectoral decarbonisation objectives. At **project level**, binding guidelines need be

introduced to enable consistent assessments of GHG emissions across programmes and Member States. To achieve the Paris Agreement objectives, it is a necessity to end funding for fossil fuel infrastructure. Infrastructure investments with an expected lifespan of more than five years should be clearly linked to the National Energy and Climate Plans (NECPs) and to national and sectoral decarbonisation pathways. The proposed hierarchy is further elaborated in the recommendations section of this report.

## 1 THE IMPERATIVE OF CLIMATE PROOFING

### 1.1 Background

The EU needs to become a climate-neutral economy as early as possible and before 2050. This is laid down in the EU long-term vision for a climate-neutral economy (European Commission, 2018b). Climate neutrality is an imperative to achieve the aims of the Paris Agreement at “holding the increase of global average temperatures well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C” (UNFCCC, 2015). Consequently, all fossil-fuels as well as only-fossil-fuel-purposed infrastructure need to be phased-out by then.

In 2013 the European Commission introduced the “climate mainstreaming” approach to the EU budget to support the achievement of the EU climate targets. EU Member States are committed to reducing their combined greenhouse gas (GHG) emissions by at least 40% domestically by 2030 compared to 1990. Under the Multiannual Financial Framework (MFF) 2014-2020, at least 20% of the total budget shall be spent on climate-relevant measures across all spending areas. In 2018 the European Commission published its proposal for the post-2020 budget period in which it proposed a climate expenditure target increase to 25% (European Commission, 2018a).

Spending a quarter of the next EU budget on climate action will result in €320 billion to be invested into mitigation and adaptation measures. This is an important signalling function to Member States and investors. However, a spending target alone is insufficient to make the EU budget compatible with the objectives of the Paris Agreement and to bring it closer to achieving the 2030 targets. It is at least equally important to ensure that any direct or indirect spending of EU funds does not lead to an increase of GHG emissions. Hence, it is necessary to fully “*climate proof*” the entire EU budget as well as investments which might be leveraged through its expenditures. This process would ensure that the energy efficiency first principle<sup>1</sup> is applied, that specific emission reduction and decarbonisation pathways are chosen, and that infrastructure is resilient to climate change impacts. Early and consistent attention to GHG emissions in the various development stages of investments would enable the implementation of better and more climate-friendly solutions to help achieve these targets.

In the current MFF, climate proofing is neither explicitly defined nor consistently applied. Major infrastructure projects funded by the European Regional Development Fund (ERDF) and the Cohesion Fund (CF) require the following procedures:

1. Mitigation assessments: Carbon footprinting and CO<sub>2</sub> shadow prices in cost-benefit analyses
2. Adaptation assessments: Vulnerability and risk assessment and adaptation responses

However, the results usually do not significantly impact investment or political decisions. Both the mitigation and adaptation assessments do not effectively exclude investments from EU funding that undermine climate-friendly expenditures as well as those that lack climate resilience.

In the next MFF, climate proofing has a broader scope as it is now included in the European Commission proposals for InvestEU, Connecting Europe Facility (CEF), ERDF and CF regulations. Still the definitions of climate proofing in these regulation proposals remain inconsistent and without a clear guidance on how to operationalise the concept. While the ERDF and CF regulation proposal explicitly excludes investments related to fossil fuels, such investments are still eligible for funding in other key infrastructure funds such as CEF and InvestEU. The European Commission is currently developing a guidance document on climate proofing. However, being a *guidance* it is unlikely to be binding, to cover all EU funds and programmes, or to set out clear rules for the exclusion of fossil fuel investments.

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<sup>1</sup> ‘Energy efficiency first principle’: Prioritisation of measures that make the demand and supply of energy more efficient in energy planning, policy and investment decisions.

## 1.2 Objective

This report provides recommendations on clear definitions and methodologies for the implementation of a mitigation-focused climate proofing concept. Climate proofing the MFF 2021-2027 will be crucial to set the EU on a climate-neutral pathway and to help achieve the 2030 climate targets. This objective can be achieved through both direct investments and important signals sent to investors and other actors.

The recommendations outlined in chapter 4 aim to support the negotiations of the respective regulations for key infrastructure funds and programmes. The proposed climate proofing hierarchy in this report, aims to support the development of binding guidelines for a consistent assessment of GHG emissions across programmes and Member States. While this report focuses on mitigation, it is also important to consider adaptation aspects.

## 2 CURRENT APPROACHES OF CLIMATE PROOFING

In the current MFF period (2014-2020), climate proofing is neither defined nor widely and consistently applied across EU funds and programmes. This chapter presents examples of assessments with climate proofing elements. These include

- cost-benefit analyses (CBA) as required for major infrastructure projects under ERDF/CF,
- a more strategic approach to assessing climate compatibility of plans and programmes in the EU as part of the Strategic Environmental Assessment (SEA),
- and lessons learned from the European Investment Bank’s carbon footprinting methodology and Emissions Performance Standard (EPS).

Our research shows that these approaches fall provide helpful elements but are not sufficient to effectively and systematically climate proof investments. The table below provides a high-level overview of the approaches analysed in this chapter.

**Table 1: Current approaches of Climate Proofing**

	CBA (ERDF/CF)	SEA	EPS (EIB)
<b>Scope</b>	Major infrastructure projects	Plans and programmes by Member States	Power sector programmes
<b>Level</b>	Project level	Programme level	Project level
<b>Fossil fuel infrastructure investments excluded</b>	No	No	No

### 2.1 Cost-benefit analyses for major projects under ERDF and CF

#### Requirements

Climate proofing is not explicitly defined in the ERDF and CF regulations. However, more than 500 “major projects” are already subject to climate proofing during project appraisal under the current MFF according to the European Commission’s spending review (Council of the European Union, 2018). Major projects are large-scale infrastructure projects that receive more than €50 million from the ERDF and/or the CF. They include most notably investments for road, rail or wastewater treatment infrastructure but also cover gas pipelines and airport projects.

Due to their importance, planned major projects are specifically listed in the Operational Programmes for each region and are subject to an assessment and a specific approval by the European Commission. Climate change adaptation and mitigation considerations are integrated in this process as set out in the Common Provisions Regulation (CPR) (European Parliament and Council, 2013). Adaptation assessments seek to ensure adequate resilience of major projects to the adverse impacts of climate change based on a vulnerability and risk assessment. Mitigation assessments seek to reduce GHG emission impacts of projects through the quantification and integration of GHG emissions in the mandatory cost-benefit analysis. CBA is an analytical tool being used for investment decisions to assess all financial and wider economic benefits and costs to society in monetary terms. The purpose of a CBA is to facilitate a more efficient allocation of resources by demonstrating that a particular project option is more convenient from a societal perspective than possible alternatives.

As part of the socio-economic assessment, the economic net present value needs to reflect GHG emissions of major projects among other technical, social and environmental considerations such as

e.g. reduced travel times (European Commission, 2014a). To this end, the volume of GHG emissions additionally emitted or saved by the project needs to be quantified and multiplied by a unit cost of CO<sub>2</sub>-equivalent expressed in Euro/tonne. This assessment is based, in part, on the EIB Carbon Footprint Methodology (see chapter 2.3). In a further step, the technical assistance partnership JASPER<sup>2</sup> supports to prepare major projects from EU Structural and Investment Funds (ESIF) and verifies the climate proofing assessments undertaken by Member States.

As part of the risk assessment which is compulsory for each CBA, the risk of investments becoming stranded assets in the future as a result of the transition to a low-carbon society can be considered, however, it is not explicitly required.

In addition, managing authorities which submit co-funding requests for major projects are required to explain how adaptation needs have been taken into account when preparing and designing the project. Beneficiaries need to assess and address the possible impacts of climate change at all stages of the project development. In this context, they need to explain which measures are planned in order to ensure resilience to current climate variability and future climate change.

## Impacts

Although these assessments of large infrastructure projects integrate GHG emission considerations in the project appraisal, it hardly resulted in the selection of low-carbon project options. There are four main reasons for this:

Firstly, carbon prices used in the assessments are set at €35/tCO<sub>2</sub>e in 2020 and €45/tCO<sub>2</sub>e in 2030<sup>3</sup>. This is at the lower end of the carbon price corridors recommended by the Stern-Stiglitz High-Level Commission on Carbon Prices for limiting the global temperature increase to 1.5-2°C (Carbon Pricing Leadership Coalition, 2017). For airport infrastructure investments, the climate impact of additional flights landing at and departing from airports as a result of EU support are monetised with an even lower carbon price of €25/tCO<sub>2</sub>e based on the Handbook on Estimation of External Costs in the Transport Sector (CE Delft, 2008).

Secondly, other non-financial benefits can easily outweigh monetised GHG emissions impacts, especially when carbon prices are assumed to be relatively low. As a consequence, projects that imply emission increases compared to a situation without the project can still be eligible for financing. For example, airport and road infrastructure investments can have wider economic benefits as a result of reduced journey times for tourists and locals. New roads can also help improve road safety and thereby reduce the number of traffic accidents.

Thirdly, fossil fuel infrastructure projects can be justified by CBA results if they reduce relative emissions. For instance, natural gas leads to GHG emissions when gas is burned for electricity generation or other uses. When argued that the project replaces more carbon-intensive fuels such as coal – which is often a more theoretical assumption – relative emissions may be decreased. However, such a project would still generate substantial amounts of absolute GHG emissions and could reduce available funds for e.g. renewable energy projects.

Fourthly, the potential long-term carbon lock-in risk is usually not considered. The CBA guide requires that a risk assessment must be carried out as part of the sensitivity analysis. Typical risks to be potentially assessed include changes in energy policy leading to the discontinuation of certain types of energy sources and fuels. However, the results of the sensitivity analysis are unlikely to significantly impact the investment decision – provided that these risks are assessed in the first place.

The current procedures for major ERDF and CF projects are therefore ineffective in ensuring that investments are fully aligned with the objectives of the Paris Agreement. They may only enable lower

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<sup>2</sup> Joint Assistance to Support Projects in European Regions

<sup>3</sup> In 2006 prices



carbon options to be favoured if monetised emissions make up a significant share of a project's non-financial costs and benefits.

## 2.2 Strategic Environmental Assessment (SEA)

### Requirements

To a limited extent, climate proofing also takes place in the Member States as part of their Strategic Environment Assessments (SEAs). SEAs provide a systematic approach for evaluating the environmental impacts of plans and programmes at national, regional or local level. They aim to ensure that environmental considerations are fully included and appropriately addressed with a view to sustainable development. The SEA Directive applies to most of the ESIF co-financed programmes in the MFF 2014-2020 (European Commission, 2017). Moreover, it applies to National Energy and Climate Plans (NECPs) as Article 10 of the Governance Regulation 2018/1999 (European Parliament and Council, 2018) obliges Member States to give the public “early and effective opportunities to participate in the preparation of the draft integrated national energy and climate plan”. SEAs will also be required for CAP Strategic Plans and results must be included in the annexes of these plans.

In general, SEAs are mandatory for plans and programmes which are:

- prepared for agriculture, forestry, fisheries, energy, industry, transport, waste/ water management, telecommunications, tourism, town & country planning or land use and which set the framework for future development consent of projects listed in the Environmental Impact Assessment Directive, or
- have been determined to require an assessment under the Habitats Directive.

For the plans and programmes not included above, the Member States have to carry out a screening procedure based on criteria set out in Annex II of the Directive to determine whether initiatives are likely to have significant environmental effects. If this is found to be the case, SEAs are required.

The “Guidance on Integrating Climate Change and Biodiversity into Strategic Environmental Assessment” report (European Commission, 2013a) includes recommendations on how to consider climate change mitigation and adaptation early in the SEA process. It stresses that the consideration of GHG emissions will be critical to the viability of plans and programmes as they are often implemented over the longer-term. Also, they may set a framework for infrastructure and other projects that will have a lifespan of many years. Similarly, resilience needs to be built in from the beginning of plans and programmes as many are likely to experience a significantly changing environment. The guidance document further recommends that SEAs should avoid ‘snapshot’ analyses (i.e. at a single point in time) and consider trends and environmental conditions with and without the proposed initiatives and its alternatives. The cumulative climate change effects are particularly important with regards to the evolving baseline.

### Impacts

The SEA Directive itself does not explicitly refer to climate change. GHG assessments are recommended in the guidance document depending on the context but are not required. Similarly, building resilience into plans and programmes at an early stage is merely a recommendation. In addition, in case of Operational Programmes SEAs are often reduced to mere ‘tick-the-box’ exercises after the programmes have been finalised (Bankwatch Network, 2014). The SEA tool in its current form therefore does not provide a robust framework of long-term impacts on the climate and of climate impacts on plans and programmes before development and appraisal.

The SEA Directive is applicable to Operational Programmes, Partnership Agreements and NECPs, but not to Projects of Common Interest (PCI). PCIs are key cross-border infrastructure projects that link energy, transport, and telecommunication systems of EU countries. In light of the before-mentioned lock-in effect of long-term infrastructure, it is crucial that also these projects undergo an

evaluation with a view to climate and energy targets. With relation to ESIF, Member States have taken the SEA Directive into consideration in the Operational Programmes as a required *ex-ante conditionality* (see box).

**Ex-ante conditionalities**

Ex-ante conditionalities (ExAC) were introduced for the ESIF to identify and address a range of factors in relation to regulatory, strategic and administrative capacity which need to be in place before the start of the programming period (Berkowitz, 2017).

There are seven general ExAC linked to the horizontal aspects of programme implementation and 29 thematic ExAC, which set out sector-specific conditions for relevant investment areas eligible for support under Cohesion Policy investment priorities (European Commission, 2013b) (see Annex II). More specifically, the following ExACs directly address aspects concerning climate and/or environment (European Commission, 2014b):

- Thematic ExAC 4 supports the shift towards a low carbon economy in all sectors.
- Thematic ExAC 5 highlights that the lack of climate change risk prevention and management could be detrimental for the effectiveness of the Fund's intervention.
- Thematic ExAC 7 promotes sustainable transport.
- General ExAC 6 refers to the beforementioned environmental legislation of Environmental Impact Assessments and Strategic Environmental Assessments. This conditionality is applicable to all Operational Programmes involving infrastructure investments.

For the next MFF period, the European Commission proposes to update the EU Cohesion Policy by replacing the ex-ante conditionalities with simplified “enabling conditions” (European Commission, 2013c).

In the regulation proposal for the next ESIF the amount of conditions is decreased from 40 ex-ante conditionalities to 20 enabling conditions. These conditions are tightly focused on the policy areas with the most impact on the effectiveness of the Cohesion policy. Besides horizontal enabling conditions, thematic enabling conditions aim i.e. at a greener, low carbon Europe.

**2.3 EIB’s Carbon Footprinting Methodology and Emissions Performance Standard**

**Requirements**

The EIB has developed methodologies that can serve as tools for climate proofing public investments, depending on the level of restriction applied.

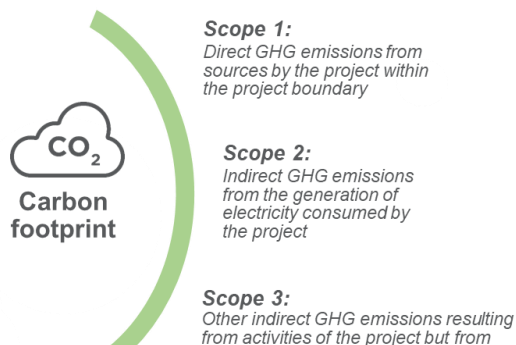


Figure 3: GHG emission scopes

Following a three-year pilot phase, the EIB has assessed GHG emissions and emission variations of projects financed by the bank since 2012 (European Investment Bank, 2018). The assessments are used for reporting the bank’s carbon footprint, for impact reporting on Climate Awareness Bonds, for economic appraisal of projects, and for EIB’s Emission Performance Standard, which serves as eligibility criterion for power sector investments. The EIB’s carbon footprint methodology is publicly available and

is in line with the International Financial Institutions Framework for a Harmonised Approach to Greenhouse Gas Accounting.

Carbon footprints are assessed for projects if absolute or relative emissions are greater than the threshold of 20,000 tCO<sub>2</sub>e/year. Guidance documents help to identify projects that are above this threshold. The assessments mainly take into account scope 1 and 2 emissions, whereas indirect scope 3 emissions that result from sources not operated by the project itself are only considered in certain cases. Most notably, GHG emissions from the combustion of natural gas in homes, industry or power stations are generally not taken into account for natural gas extraction, pipeline and LNG terminal projects if they contribute to GHG emission reductions (Bankwatch Network, 2016).

To estimate relative emission reductions, EIB uses the most likely alternative option for the financed projects as a baseline (Bankwatch Network, 2016). This baseline usually represents a business-as-usual case instead of alternative socially, environmentally and economically feasible and acceptable options for reaching the EU's climate targets. For example, for investments into an all-electric bus fleet the baseline would represent emissions of a modern standard bus fleet rather than an outdated bus fleet, but the investment would not be assessed against alternative low-carbon options such as hybrid electric or fuel cell buses.

GHG emissions assessments are used for economic appraisal in form of cost-benefit analyses of e.g. transport projects. For this purpose, emissions are multiplied with EIB's shadow carbon price which is currently set at €38/tCO<sub>2</sub>e and increases in future years. This price level is at the lower end of the carbon price corridors recommended by the High-Level Commission on Carbon Prices (Carbon Pricing Leadership Coalition, 2017).

For fossil fuel generation projects, the Emissions Performance Standard (EPS) is applied. The EPS aims to enable a transition to a low-carbon economy by screening out investments with carbon emissions that exceed a specified threshold level. The threshold is currently set at 550 gCO<sub>2</sub>/kWh in order to reflect existing national and EU commitments to limit carbon emissions as established in the European Emissions Trading System (ETS).

### Impacts

Cost-benefit analyses are required for EIB investments into natural gas networks, however, such projects are still eligible for financing as CBA results usually do not lead to the exclusion of fossil fuel infrastructure projects (also see chapter 2.1). In fact, investments in natural gas transmission, distribution and storage amounted to €7.9 billion between 2013 and 2017 (Bankwatch Network, 2018).

The introduction of the EPS successfully ruled out further lending of the EIB to regular coal and lignite power plants in the EU. The EPS thus can be an effective and transparent tool to rule out power generation plants based on their CO<sub>2</sub> emissions. With an EPS at 550 gCO<sub>2</sub>/kWh most gas-fired powerplants are still eligible for funding. With a view to climate proofing the EPS value would need to be drastically reduced.

### 3 CLIMATE PROOFING IN THE NEXT MULTIANNUAL FINANCIAL FRAMEWORK

#### 3.1 Definitions of climate proofing

In current proposals of the European Commission, regulations and council decisions, seven EU funds and programmes which focus on infrastructure investments include references to climate proofing:

- European Regional Development Fund
- Cohesion Fund
- InvestEU
- Connecting Europe Facility
- Instrument for pre-Accession (IPA III)
- Neighbourhood, Development and International Cooperation Instrument (NDICI)
- Council Decision on the association of Overseas countries and territories establishing the funding in form of a Programme (OCTP)

The proposed definitions of climate proofing of each of these programmes can be found in the Annex.

When taking a closer look, one notes that the proposal for the ERDF and CF does not explicitly refer to the consideration of total GHG emissions, of costs of GHG emissions or the positive effects of climate mitigation measures in the economic evaluation of projects (see Table 2). In fact, the proposed Common Provisions Regulation no longer includes provisions such as CBAs for major projects. In contrast, the CEF regulation proposal refers to both mitigation and adaptation aspects of climate proofing and states that “projects supported by the Programme [...] be subject to climate proofing in accordance with guidance that should be developed by the Commission”.

The definition of climate proofing in the InvestEU proposal is broader, referring to “sustainability proofing” which includes climate, environmental and social sustainability proofing and stresses that undue administrative burdens should be avoided. The European Territorial Cooperation Regulation states that when selecting projects, the monitoring committee or, where applicable, the steering committee shall ensure climate proofing for investments in infrastructure with an expected lifespan of at least five years. A full overview of climate proofing related sections of the relevant regulation proposals can be found in Annex.

Table 2: Overview of climate proofing in regulation proposals for the next MFF

EU Fund	Reference to EC guidance document	Resilience to adverse impacts of climate change	Cost of GHG emissions in economic evaluation	Scope
ERDF, CF		✓		Infrastructure investments with an expected lifespan of at least five years
CEF	✓	✓	✓	Supported projects where relevant
InvestEU	✓	✓	✓	Notably infrastructure; size threshold to be defined in guidance
IPA III, NDICI, OCTP				Infrastructure investments with an expected lifespan of at least five years

### 3.2 Links to the Sustainable Finance Taxonomy under InvestEU

The InvestEU regulation proposal links the climate proofing concept to the Sustainable Finance Taxonomy, requiring that “the criteria established by [Regulation on establishment of a framework to facilitate sustainable investment] for determining whether an economic activity is environmentally sustainable” should be used in an appropriate way. Most notably, this latter clause is important to foster consistency for the definition of what is “green” and what is not. Indeed, according to Article 3 of the legislative proposal for the creation of a Sustainable Finance Taxonomy, an economic activity shall be environmentally sustainable where that activity complies with the following criteria:

- It contributes substantially to one or more of the environmental objectives set out in Article 5 of the regulation in accordance with Articles 6 to 11
- It does not significantly harm any of the environmental objectives set out in Article 5 in accordance with Article 12
- It is carried out in compliance with minimum safeguards laid in Article 13
- It complies with technical screening criteria

The “do no harm” criterium is, to a certain degree, a cornerstone for environmental legislation. If an economic activity is defined to be green if it does not significantly harm environmental objectives then, the reverse should also be true. Which means that any economic activity that, for instance, is carbon intensive should be defined as detrimental for environmental sustainability. The Taxonomy regulation does not yet encompass so called “brown” economic activity and only focuses on what is clearly environmentally sustainable. This is a substantial limitation, especially in the light of climate proofing. Without a Taxonomy which encompasses the categorization of both “green” and “brown” economic activities, climate proofing for the InvestEU fund is unlikely to prevent investments that undermine the objectives of the Paris Agreement.

### 3.3 EU Parliament's amendments to the InvestEU regulation

The European Parliament's amendment to the InvestEU regulation proposal (European Parliament, 2019a) lists activities that should be excluded from funding<sup>4</sup> such as:

*"Investments related to mining / extraction, processing, distribution, storage or combustion of **solid fossil fuels and oil** as well as investments related to extraction of **gas**."*

This proposal would still allow funding for processing, distribution, storage or combustion of gas. Besides, this 'negative list' is not explicitly linked to the amendment to Article 7 which states that:

**"Projects that are inconsistent with the achievement of the climate objectives shall not be eligible for support under this Regulation."**

### 3.4 EU Parliament's amendments to the climate proofing definition in the CPR

On 13 February 2019, the European Parliament adopted the following amendments to the CPR proposal (European Parliament, 2019b) which would allow for a more effective climate proofing approach.

The Parliament's amendment to Recital 9 requires that:

*"climate proofing mechanisms should be an **integral part of programming and implementation**."*

For this purpose, climate proofing and the energy efficiency first principle are defined as follows in additions to Article 2:

*"(37) '**climate proofing**' means a process to ensure that infrastructure is **resilient to the adverse impacts of the climate** in accordance with internationally recognised standards or national rules and guidance, where available, that the **energy efficiency first principle is respected** and that **specific emission reduction and decarbonisation pathways** are chosen;"*

*"(36a) '**energy efficiency first principle**' means the **prioritisation**, in energy planning, policy and investment decisions, of **measures that make the demand and supply of energy more efficient**;"*

More specifically, the amendment to Article 4 paragraph 3 requires that:

*"Member States shall **ensure climate proofing for relevant operations through the entire planning and implementation process** and shall provide information on the support for environment and climate objectives using a methodology based on types of intervention for each of the Funds."*

The amendment to Article 67 paragraph 3 further specifies that climate proofing should not be a box ticking exercise. Instead managing authorities selecting operations shall:

*"(j) ensure, **before taking investment decisions**, the climate proofing of investments in **infrastructure with an expected lifespan of at least five years**, as well as the **application of the Energy Efficiency First principle**."*

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<sup>4</sup> This exclusion would not apply to: i. projects where there is no viable alternative technology; ii. projects related to pollution prevention and control; and iii. projects equipped with Carbon Capture, Storage or Utilisation installations; industrial or research projects that lead to substantial reductions of greenhouse gas emissions compared to the applicable Emission Trading Scheme benchmark(s).

## 4 RECOMMENDATIONS FOR SOUND AND CONSISTENT CLIMATE PROOFING

Current climate proofing methodologies and requirements applied to some parts of the EU budget and EIB's portfolio are insufficient in aligning EU budget expenditures with transition pathways towards a climate neutral Europe as discussed in chapter 2. In chapter 3 our research furthermore shows that the proposals for climate proofing the next MFF lack coherent definitions and requirements. Investment choices taken today will be critical for achieving the mid- and long-term EU climate targets, considering that infrastructure investments typically have a lifetime of more than 50 years. Therefore, climate proofing needs to ensure the transformational impact of the entire EU budget.

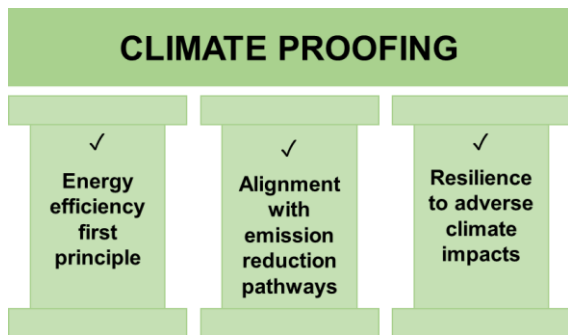


Figure 4: Climate proofing concept definition

We recommend a **consistent definition of the climate proofing concept to be applied** in the regulations for all relevant EU funds and programmes. A consistent definition would cover the energy efficiency first principle, the consideration of specific decarbonisation pathways and resilience to adverse climate change impacts. The Parliament's amendments to the proposal for the CPR for the ESIF outlined in chapter 3.3 provide useful additions to definitions and requirements. Definitions and requirements would also need to be binding for other EU funds and

programmes relevant for infrastructure investments, such as CEF, InvestEU, IPA III, NDICI and OCTP. Given that there is currently no regulation with overarching rules for all EU funds and programmes, the CPR could be amended to support this cause. In the case of Horizon Europe and CAP, research funding and agriculture spending, respectively, need to be aligned with sector-specific emission reduction pathways. If no overarching requirements can be agreed on, the relevant sections could be incorporated into articles of the respective regulations.

More specifically, we recommend implementing the mitigation elements of the proposed climate proofing requirements by following a **climate proofing hierarchy** which would focus on the first two pillars of the climate proofing definition and enshrine this in the relevant regulations.

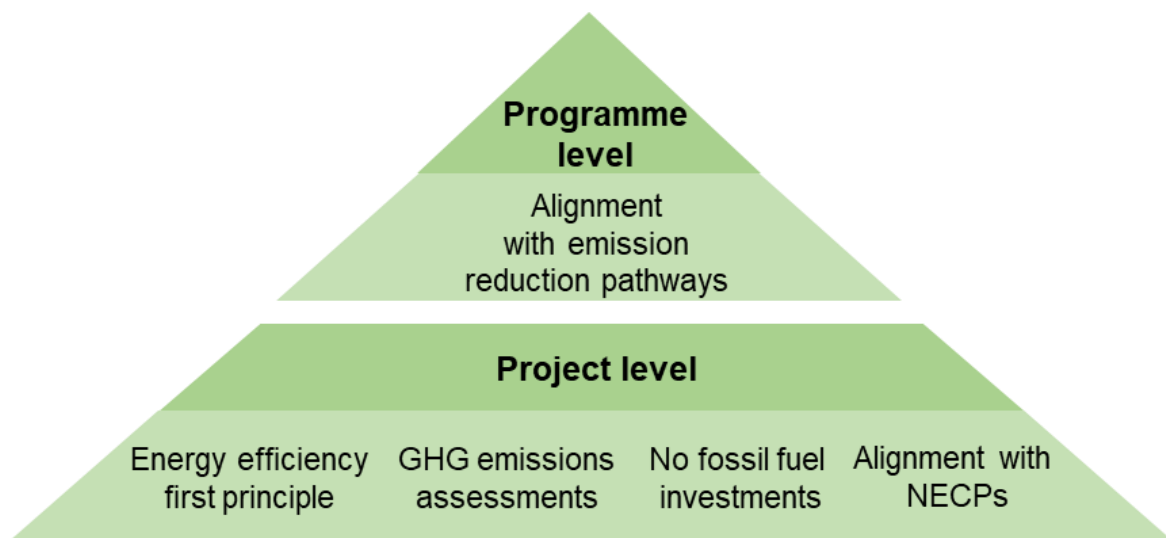


Figure 5: Mitigation-focused climate proofing hierarchy

### 1. Programme-level climate proofing

Strategic assessments on the programme level can build on lessons learned in the Strategic Environmental Assessments which provide a systematic process for evaluating the environmental and climate impacts of proposed plans and programmes (see chapter 2.2). When designing ESIF Partnership Agreements, Operational Programmes, CAP Strategic Plans and other country-specific plans such as NECPs by the Member States, these need to be based on **sectoral decarbonisation objectives**. An alignment with the Paris Agreement for investments in transport, housing, energy, industry, agriculture and research can then be assessed by the European Commission.

Planning documents by Member States for the next MFF period need to describe a clear decarbonisation pathway in line with the EU's climate and energy targets and the Paris Agreement. Therefore, sufficient ambition in reducing emissions in all sectors is a prerequisite. The low-carbon transition in each sector should be enabled by a **systematic approach that embeds mitigation considerations in all planning documents**. This is to ensure that programmes do not fund emission-intensive activities that undermine any climate-related targets. **These expenditures, notably for fossil fuel infrastructure and related research, could be excluded through a negative list**. Such a list could be enshrined in the CPR and made binding for all relevant funds in close alignment with the Sustainable Finance Taxonomy.

If the plans fall short in showing full alignment with the net-zero emissions goal in 2050, the European Commission is enabled to reject the plans and demand adjustments. Similarly, sectoral decarbonisation objectives for sector-specific funds and programmes such as Horizon Europe, InvestEU and CEF need to be taken into account. For example, when drawing up the list of Projects of Common Interest, the European Commission can ensure that infrastructure investments are compatible with the Paris objectives based on the proposed negative list.

### 2. Project-level climate proofing

It is also recommended to carry out assessments on project level where relevant. For infrastructure projects with an expected lifespan of more than five years, as stated in ERDF and CF regulation, the European Commission could provide **binding recommendations to ensure consistent assessments of GHG emissions** across Member States building on the Cohesion Policy CBA Guide and the EIB Carbon Footprint Methodology. In this context, an update of carbon prices used in these assessments to the **upper end of the carbon price corridors** recommended by the High-Level Commission on Carbon Prices seems needed. To capture all GHG emission impacts of a project, **all direct and indirect emissions (Scope 1, 2, and 3)** should be taken into account. Baselines for CBA assessments should reflect alternative socially, environmentally and economically feasible and acceptable options for decarbonising the economy rather than business-as-usual options to ensure genuine relative and absolute emission reductions.

We recommend **ending investments into fossil fuel-based power generation and infrastructure based on funding from the EU budget**. Gas infrastructure investments should only be financed if it can be plausibly proven that the infrastructure will be used exclusively for transporting biogas and/or hydrogen. It should be noted that the geography of biogas and hydrogen production may differ significantly from supply of fossil gas and as a consequence may only be poorly adapted. Investments should therefore focus on distribution rather than transmission infrastructure and be limited in volume, taking into account both lock-in risks and projections of decreasing gas demand in the coming decades as highlighted in the European Commission's long-term strategic vision.

We recommend that infrastructure investments with an expected lifespan of more than five years are **clearly linked to the National Energy and Climate Plans (NECPs)** and Member States required to clarify how infrastructure investments fit into national and sectoral decarbonisation pathways.



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## ANNEX: OVERVIEW OF EUROPEAN COMMISSION PROPOSALS FOR THE NEXT MFF WITH RELEVANCE FOR CLIMATE PROOFING

The table below provides an overview of commission proposals for the next MFF period with reference or relevance for climate proofing.

European Commission Proposals	Content	Status legislation
<p>Legal proposal for the InvestEU Programme COM/2018/439 final – 2018/0229/COD/</p>	<p>Article 7:</p> <ul style="list-style-type: none"> <li>- defines the four policy windows (infrastructure, research, SME, social) and stipulates that operations under the sustainable infrastructure policy window shall be subject to climate, environmental and social sustainability proofing;</li> <li>- as regards to adaptation apply a climate vulnerability and risk assessment and, as regards mitigation, a cost-benefit analysis;</li> <li>- European Commission will develop guidance on sustainability proofing.</li> </ul>	<ul style="list-style-type: none"> <li>- 7 September 2018: InvestEU Working Group meeting drafted Investment Guidelines</li> <li>- Investment Guidelines would be adopted by the European Commission Decision as a Delegated Act once a political agreement on InvestEU has been achieved</li> <li>- On 21 February 2019 European Commission welcomed positions of Member States on InvestEU</li> <li>- The Proposal for a Regulation establishing the InvestEU Programme is under First Reading at the Council of the European Union since 15/01/2019</li> </ul>
<p>Legal Proposal for Connecting Europe Facility (CEF) COM/2018/438 final – 2018/0228/COD</p>	<p>Recital (4) defines that projects (covering both mitigation and adaptation) should be subject to climate proofing in accordance with guidance provided by the European Commission:</p> <p><i>“In order to prevent that infrastructure is vulnerable to potential long term climate change impacts and to ensure that the cost of greenhouse gas emissions arising from the project is included in the project’s economic evaluation, projects supported by the Programme should be subject to climate proofing in accordance with guidance that should be developed by the Commission coherently with the guidance developed for other programmes of the Union where relevant”;</i></p> <p>Article 13 defines a set of award criteria including:</p> <ul style="list-style-type: none"> <li>- Economic, social and environmental impact;</li> <li>- The assessment of proposals shall take into account, where relevant, the resilience to adverse impacts of climate change.</li> </ul>	<ul style="list-style-type: none"> <li>- First Reading at Council of the European Union since 23/10/2018</li> </ul>

	European Commission Proposals	Content	Status legislation
Legal Proposals for European Regional Development Fund and Cohesion Fund	Legal Proposal for a Common Provision Regulation (CPR) COM/2018/375 final – COM/2018/0196(COD)	<p>The CPR provides a framework for a number of funds implemented through shared management including the European Regional Development Fund (ERDF) and the Cohesion Fund (CF)</p> <p>Recital (37) defines climate proofing;</p> <p>Article 67 stipulates that the managing authority when selecting operations among other shall “ensure the climate proofing in investments in infrastructure with an expected lifespan of at least 5 years”;</p> <p>Important to note: the proposed CPR no longer includes provisions on major projects, given that climate proofing has been expanded to cover all ERDF/CF infrastructure projects with a lifespan of at least 5 years.</p>	<ul style="list-style-type: none"> <li>- First Reading at Council of the European Union since 25/01/2019</li> </ul>
	Legal Proposal on specific provisions for the European territorial cooperation goal (Interreg) COM/2018/374 final – 2018/0199/COD	Article 22 (4j) defines that the steering committee shall ensure the climate proofing of investments in infrastructure with an expected lifespan of at least five years.	<ul style="list-style-type: none"> <li>- First Reading at Council of the European Union since 23/01/2019</li> </ul>
	Legal Proposal for the establishment of a framework to facilitate sustainable investment COM/2018/353 final – 2018/0178 (COD)	<p>Article 3 defines the criteria for an economic activity to be defined environmentally sustainable:</p> <ul style="list-style-type: none"> <li>(a) It contributes substantially to one or more of the environmental objectives set out in Article 5 in accordance with Article 6 to 11;</li> <li>(b) It does not harm significantly any of the environmental objectives set out in Article 5 in accordance with Article 12;</li> <li>(c) It is carried out in compliance with the minimum safeguards laid down in Article 13;</li> <li>(d) It complies with technical screening criteria, where the Commission has specified those in accordance with Articles 6(2), 7(2), 8(2), 9(2), 10(2) and 11(2)</li> </ul> <p>Article 4 defines that MS shall apply the criteria for determining environmentally sustainable economic activities set out in Article 3 for the purposes of any measures setting out requirements on market actors in respect of financial products or corporate bonds that are marketed as “environmentally sustainable”</p>	<ul style="list-style-type: none"> <li>- First reading at Council of the European Union since 08/03/2019</li> <li>- Trilogue negotiations and technical work in the running</li> </ul>