Understanding and Influencing the EU Budget Review

Draft Final Report for the Environment Agency

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1 INTRODUCTION

A wide-ranging review of the pattern of European Union (EU) spending and its sources of revenue is being undertaken by the European Commission in 2008/9 as required by the Council at the time when the current budget was finalised. Although the EU budget has changed over time, budget reforms have tended to have an inbuilt conservatism and the majority of observers now agree that the allocation of budget is out of sync with the main objectives and policy goals of the EU. However, through this budget review process the Commission has promised slightly disingenuously a 'no taboos' debate on the future direction of the budget (CEC 2007a). Therefore, the stage has been set for an unprecedented opportunity to assess the EU's current and future budgetary priorities which could help to pave the way to an agreement on a rebalanced Financial Perspective for the period after 2013.

This report sets out the budget review debate so far as well as pointing out the key issues of reference to the environment which are likely to be on the agenda in the next stages of the debate and subsequent budget negotiations. The report focuses on EU spending which has implications for the Environment Agency and therefore concentrates on spending on climate change (mainly within the Structural and Cohesion Funds but also through funding for Research and Development), 'sustainable land use management' (within the Common Agricultural Policy), and the implementation of EU environmental legislation in general (also mainly through the Structural and Cohesion Funds but also through LIFE+). The revenue side of the EU Budget, which is also part of the review agenda, is not considered here. The paper aims to assist the Environment Agency in developing a detailed understanding of the EU budget review process, the underlying principles and key time lines as well as the key players in the debate. It is intended that this understanding will ultimately help to inform policy priorities and principles which the Environment Agency could follow as it participates in the debate.

2 THE EU BUDGET

2.1 What is the EU budget?

In 2009 the EU has a total budget of €133.8 billion. While the EU budget appears quite large in absolute terms, it is relatively small considering it part finances several common policies operating in 27 Member States. The EU budget is in fact only 2.5 per cent of public expenditure in the Union and around 1 per cent of the Union's Gross National Income, well below its official upper limit of 1.24 per cent. The lion's share of this money, around 76 per cent, is spent on the Common Agricultural Policy (CAP) and Structural Funds. However, these spending priorities are not set in stone and the budget can, and has, changed. Over the past 20 years there have been significant shifts (albeit incremental) in patterns of EU spending, reflecting changing priorities (Baldock and Wilkinson 2006). For instance, spending on the CAP has declined from 60 per cent of the budget in 1988 to around 40 per cent of the budget today. Conversely, the Structural Funds have increased from 17 per cent to nearly 36 per cent of the budget in the same time frame. New funds and budget lines have also been added over the years, such as the Cohesion Fund created in 1993 for the benefit of the poorest Member States.

Since the late 1980s, the EU has set multi-annual financial frameworks for the Community's budget priorities over a period of several years, in so-called 'Financial Perspectives'. These include the maximum amounts (ceilings) of financial commitments for different categories of spending priorities (budget headings) which must be respected in annual budgets. The current Financial Perspective runs from 2007 to 2013 for which a total budget has been set at €864 billion. Table 1 shows a break down of EU spending in the current Financial Perspective according to these budget headings.

Table 1. The 2009 EU Budget

Budget Heading	Euros Billions
1. Sustainable Growth	**60.2**
1A. Competitiveness for growth and employment	11.8
1B. Cohesion for growth and employment	48.4
2. Preservation and management of natural resources	**56.1**
2A. Agricultural expenditure including direct aids	41.1
2B. Rural Development	13.7
2C. Environment	0.3
2D. Fisheries	0.9
3. Citizenship, freedom, security and justice	**1.5**
4. The EU as a global player	**8.1**
(excludes the extra-budgetary European Developm Fund)	
5. Administrative expenditure	**7.7**
6. Compensation to new EU countries	**0.2**
Total	**133.8**

Decision making on the EU budget is not straightforward. Annual budgets within the Financial Perspective framework are drafted by the Commission and voted on by the Council (by qualified majority voting) and by the European Parliament (by absolute majority). The Council has the last say on 'compulsory' expenditure - spending which is laid down for in the Treaties and most notably includes the CAP. The European Parliament has the last say on all the rest of the spending. The Financial Perspectives on the other hand are proposed by the Commission but decided on by the Council by unanimity. The European Parliament negotiates with the Council and then votes a (non binding) resolution accepting the Council decision. The Financial Perspective is then enshrined in an inter-institutional agreement. These arrangements are not codified in any legal document setting out the budgetary procedures (unlike the annual budgets) and are renewed by consensus by the three institutions at the end of each Financial Perspective.

This dual system of decision-making gives rise to a number of draw backs. The yearly budget – which is the only budgetary instrument with legal value under the Treaty – is not the real seat of budgetary power. Significant decisions on the EU budget (such as setting the ceilings for the CAP and Structural Funds) are in practice taken by the Council outside the Community Method and based on intergovernmental negotiations (Gros and Micossi 2005). However, if the Lisbon Treaty comes into force, this situation will be changed somewhat by increasing the powers of the European Parliament in areas of compulsory expenditure (most notably the CAP). However the Financial Perspectives will still be decided by unanimity in the Council.

2.2 EU spending on the environment

The difficulty of discussing the budget in terms of environmental funding is that the EU budget is complex and there is no one overall fund for environmental spending. After the failure of the European Parliament in the early 1990s to establish a sizable, separate Environmental Fund, most environmental spending is 'mainstreamed'[1] into other funds within the EU budget. LIFE+ is the only dedicated environment fund administered by DG Environment, and amounts to just 0.2 per cent of the EU budget. This mainstreaming of environmental spending can bring some advantages. For example, it makes use of

[1] More specifically by 'mainstreaming' of environmental spending we refer to where the delivery of projects for which the primary purpose is to advance economic or social objectives is undertaken in such as way that they also contribute to environmental aims in the EU budget.

existing funds to advance environmental objectives while also potentially reducing the chances that EU spending in relation to other objectives of the EU will undermine environmental objectives.

On the other hand, mainstreaming makes it difficult to assess what is actually spent on environment-related projects. Part of this is due to the way in which spending is categorised (see Table 1 above). For example, the heading 'preservation and management of natural resources' is rather misleading as it is mainly spending on the CAP of which over 73 per cent is in direct aids to farmers. Even when looking at specific policies or funding instruments, it is often not easy to ascertain how spending is allocated between different priorities. For example, within the €56.1 billion spent in 2009 on CAP, €13.7 will be on rural development initiatives which includes agri-environmental and other environmental measures. This is further complicated by the variations between planned expenditure and actual spending decisions that are highly decentralised and not transparent. Around 76 per cent of the EU's expenditure is not under the direct control of the Commission. Instead it is actually spent indirectly through the governments or local authorities of Member States who make decisions on detailed programmes and projects. While there are guidelines set by the Commission on how this money is spent, these are so broad and wide ranging that Member States still have extensive discretion on how they spend much of this money.

The most important areas in which environmental spending has been integrated are the CAP and Structural Funds[2]. The principal purpose of the Structural Funds is to promote the economic and social development of disadvantaged regions, sectors and social groups within the EU but a significant revision of the Structural Fund Regulations in 1993 broadened the eligibility criteria for projects and introduced a number of environmental safeguards and opportunities for environmental spending. Article 17 of the new Structural Funds General Framework Regulation (1083/2006) states that 'the objective of the funds shall be pursued in the framework of sustainable development and the Community's promotion of the goal of protecting and improving the environment'. Legally-binding 'Community Strategic Guidelines' (CEC 2005) for Structural Funds now refer to a number of environment-related projects that Member States are encouraged to develop. These include: environmental infrastructure to comply with EU legislation in the fields of water, waste, air, and nature protection; waste prevention and recycling; rehabilitation of the physical environment, including natural and cultural assets, as attractive industrial locations. In addition, the scope of the Cohesion Fund has been extended in the current Financial Perspective to include support for energy conservation and support for the development of renewable forms of energy. However, despite these new provisions in the Structural Funds for environmental spending, it is evident that these environmental objectives are not being given priority in the implementation of the funding instruments (see section 4).

Over time, support for environmental management has also become increasingly integrated within the framework of the CAP and this has been reflected in agricultural spending. In particular, a new 'pillar' of the CAP (Pillar Two) concerned with rural development and funded by the European Agricultural Fund for Rural Development (EAFRD) has been created. This provides part funding for national and regional rural development programmes, an objective of which - as set out in the Community Strategic Guidelines for Rural Development - is 'improving the environment and the countryside by supporting land management'. These priorities primarily relate to the Göteborg

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[2] The Structural Funds are in fact a number of different funds: including the European Regional Development Fund (ERDF); the European Social Fund (ESF); and the Cohesion Fund.

sustainability goals laid down in the EU's original 2001 Sustainable Development Strategy and the objectives of the Lisbon Strategy for Growth and Jobs. However, despite the growth in the budget available for Pillar Two, environmental objectives still only play a marginal role in the CAP.

2.3 The EU budget review

The Budget review has its origins in the negotiations of the current financial perspective in 2005 with the then Prime Minister, Tony Blair, raising the fundamental question of EU spending priorities. A direct result was a request by the European Council for the Commission to 'undertake a full, wide ranging review covering all aspects of EU spending, including the CAP, and of resources, including the UK rebate' (European Council 2005). Consequently, in September 2007, the Commission launched a consultation document '*Reforming the budget, changing Europe'* which considered the policy challenges facing Europe, and whether these are adequately reflected in spending priorities (CEC 2007a). A number of fundamental questions were raised about the added value of European spending, and the effectiveness, efficiency and transparency of budget delivery.

After an extended consultation period lasting until mid-June 2008, nearly 300 responses were received the majority of which were posted on the Commission's website (CEC 2008a). Contributions were submitted from all 27 Member States, NGOs, the private sector, academics, think tanks, regional authorities and agencies. Dalia Grybauskaite, the Budget Commissioner, presented a Commission Working Document summarising these responses at a large stakeholder conference held in Brussels on 12 November 2008. Climate change was at the top of the list of future challenges to the EU as highlighted in the consultation summary (two thirds of contributors considered it Europe's biggest test for the future); followed by EU competitiveness in a global economy; and energy security. A number of suggested changes in relation to environmental spending were included in the Commission's summary including: increasing direct spending on the environment and climate change; aligning other policies with environmental needs; investing in energy efficient technologies; and developing renewable energy. The Commission stated that the CAP was the most controversial area of current EU spending with a strong signal being given that it should be reformed.

It is useful to reflect that this current review of the EU budget is a unique process initiated in the context of a specific set of political circumstances. The review period spans several years and is far in advance of the normal budget negotiations which take place prior to agreement of a new Financial Perspective. Therefore, it is highly unlikely that the contents of these first proposals, and their consequent discussion in the European Parliament and Council, will move beyond the level of principle to begin to discuss actual figures. This more detailed level of negotiations is likely to take place much nearer the end of the current Financial Perspective, after more detailed proposals from the Commission which are currently expected no later than July 2011. It is hoped, however, that this budget review debate will provide the opportunity for Member States and stakeholders to engage in considered critique of the EU budget based on principles and ideals rather than the usual practical and political considerations which dominate budget negotiations. The next section of this paper sets out very briefly some of the principles and ideals which have been introduced into the debate so far.

3 PRINCIPLES UNDERLYING THE EU BUDGET REVIEW DEBATE

A number of principles or criteria have been applied to evaluating the merits or other wise of different spending priorities (current and potential). Most notably the UK Treasury has developed three so-called 'Balls Principles' (HM Treasury 2008). These are:

1. *'Added value'*: that the EU should act only where there are clear additional benefits from collective efforts compared to action solely by individual Member States - rather than 'more EU' for the sake of it. This includes, but in important respects goes beyond, the subsidiarity principle.
2. *'Best policy instrument'*: where EU-level action is appropriate, the policy instrument that is most suitable to delivering the policy objectives should be chosen. Expenditure is only one of a range of policy instruments. Other possible policy actions may offer direct alternatives to EU budget spending.
3. *'Sound financial management'*: expenditure must be efficient and effective. Spending programmes should be free of corruption, should achieve objectives and be evaluated and monitored systematically during and after implementation.

The first two principles relate to the need to ensure that the budget is spent on the right things and the third that the money spent is not wasted.

Of these three principles, the first principle of 'value added' or more specifically '*EU value added'* is perhaps the most widely used in the budget review debate and was discussed by the Commission in its original consultation document. This states that 'EU spending must therefore be based on an assessment of the added value of the different aspects of EU spending' (CEC 2007a, 7). The EU can be regarded as providing 'added value' in a number of circumstances: First, where it accords with the principle of subsidiarity; Second, where some redistribution of benefits or costs between the Member States is considered desirable; Third, where the provision of emergency relief to individual regions or Member States in the event of major natural disasters is a distinct type of EU action – this is the principle of solidarity.

The *subsidiarity principle* is outlined in Article 5 of the EC Treaty[3] which states that:

> *'In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community'.*

This principle was first developed in the context of environmental policy but is now used in the allocation of tasks and responsibilities between the EU and Member States more broadly.[4] It is a political and most importantly a dynamic concept and therefore, the areas in which EU action is viewed as being more effective than that of the Member States can change over time. For example, climate change is a relatively new challenge which is generally regarded as best dealt with at an EU level due to its transboundary nature. The principle of subsidiarity is also often used to justify the pooling of resources between Member States to take advantage of economies of scale, such as through a collective Research and Development (R&D) effort.

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[3] The 'subsidiarity principle' is explained in more detail in Protocol 30 'On the application of the principles of subsidiarity and proportionality' annexed to the EC Treaty.

[4] Strictly speaking the principle of subsidiarity is only applied to those policy areas which are shared between the EU and Member States and not those which the EU has sole competency such as the CAP.

The principle of *Redistribution* is usually more implicit in many of the EU's funding instruments. For example, there are Treaty provisions lending explicit support to cohesion policy, which is a form of redistribution. The EU has a legitimate role in redistributing benefits and/or costs between the Member States, in the same way that national governments do in relation to their poorer regions. Some commentators argue that, from an ideological perspective, redistribution should be considered as an 'inherent component of the project of European integration' (Jouen and Rubio 2007, 12). Redistribution can result in some important 'leverage effects' through the provision of redistributive funding with interesting 'strings attached'. Thus, redistribution can provide multiple benefits to recipient territories beyond those of the co-financed projects, including delivering environmental objectives. The question then becomes - what should financial transfers from richer to poorer Member States be spent on?

The redistribution argument can be extended beyond the redistribution of benefits, in terms of money or in kind, to include attempts to balance unequal costs imposed on Member States in seeking to meet Community objectives. That is to say, redistribution can be used to justify compensatory payments for disproportionate contributions to common EU goals. This has already been recognised through the establishment of the Cohesion Fund. Article 175(5) of the EC Treaty specifically authorises the Council to lay down appropriate provisions in the form of financial support from the Cohesion Fund if an environmental policy measure 'involves costs deemed disproportionate for the public authorities of a Member State'. This provision has already been applied, for example, to contribute to the costs in the poorer Member States of meeting the requirements of EU water treatment and waste management legislation. In addition, the most cost-effective means for the EU to meet collective European environmental targets may well impose disproportionate burdens on some Member States.

Solidarity is a further principle used in the budget review debate, and one which is closely related to the issue of redistribution. It is defined as the 'unity of interests, or sympathies among members of a group' (Collins 2009). The provision of emergency relief to individual regions or Member States in the event of major natural disasters is a distinct type of EU action. Following major floods in 2002 in Germany, Austria, France and the Czech Republic, the EU set up a Solidarity Fund (EUSF) which is triggered when the cost of damage exceeds a certain threshold. This fund could have considerable implications in the context of Member States' adaptation to climate change. Article 2 of the EUSF Regulation (2012/2002) states that the fund should be mobilised 'when a natural disaster with serious repercussions on living conditions, the natural environment, or the economy in one or more regions or one or more countries occurs'. Eligible actions include 'the immediate cleaning-up of disaster-stricken areas, including natural zones'. This would justify collective EU action to protect or reinstate affected sites threatened by a major emergency in a particular Member State. What is less clear, however, is whether the EUSF could be used to address some of the longer term consequences of climate change (see section 4).

The concept of *Public Goods* has emerged as a key principle in discussions about the future justification for EU spending on agriculture. Public goods can be technically defined as those goods which are defined by the attributes of non-rivalry and non-excludability (Samuelson, 1954). The lack of a market, coupled with a high public demand for these goods - such as biodiversity, climate mitigation and adaptation, and a sustainable resource base - underpins the case for state intervention. However, as will be discussed in section 5, a large number of questions relating to the concept of public goods needs still need to be answered before it can operationalised.

The principle of *'best policy instrument'* to deliver the desired policy objectives argues that expenditure is only one of a range of policy instruments. Other possible policy actions include regulation, market-based instruments, voluntary agreements etc. In some cases, policy objectives may be secured equally effectively through more than one of these instruments which may offer direct alternatives to EU budget spending (Baldock and Wilkinson 2006). However, there are numerous circumstances where neither 'hard regulation' nor 'soft law' is enough and financial incentives are required to induce Member States to adjust their policies to EU priorities (Jouen and Rubio 2007). For example, alternative policy instruments themselves normally involves costs such as for the appointment of staff, training and capacity-building, the establishment of institutions, the engagement of professional specialists.

While the discussion of principles is useful and necessary in the EU budget review debate, it is important to remember that these values and criteria have not been the over-riding logic of decision making on budget allocations in the past. Instead decision making has been dominated by the logic of *'juste retour'* where Member States have fought to increase the net balance of their country's contributions to the EU budget compared to their receipts.

4 CLIMATE CHANGE

4.1 Why spend on climate change?

The EU has identified the mitigation of climate change as one of its key policy objectives[5] so perhaps it is not surprising that climate change is high on the agenda of the budget review debate. Several studies have recently highlighted the important role that EU funding instruments can play in the EU's approach to achieving its climate change objectives (Green Alliance 2007; Adelle *et al* 2008; ECORYS *et al* 2008; Egenhofer *et al* 2008). There are some strong arguments for using the EU budget in the fight against climate change. First, the transboundary nature of climate change means that it cannot be solved effectively by individual Member States and provides a strong rationale for EU action according to the principle of subsidiarity. The related principles of common pooling of resources and the economies of scale also provide a particularly strong case for expenditure in the area of R&D as well as the deployment of green energy technologies. Tackling climate change will require investment in specific cleaner energy technologies (such as Carbon Capture and Storage) which take considerable investment to get them up and running and viable for effective deployment. In all these areas, significant benefits would accrue to all EU citizens while the transboundary nature of climate change impacts makes underspending in research by national governments more likely (ECORYS *et al* 2008).

In terms of redistribution, there are strong arguments for ensuring more adherence to climate change objectives in the implementation of the redistribution of benefits of the EU ie through the Cohesion Fund and convergence funds in the Structural Funds. Depending on what these funds are spent on, they can be used not just to redistribute funds from richer to poorer Member States, but also to facilitate the implementation of the EU's

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[5] The EU is determined to limit global average temperature increases to less than 2°C compared to pre-industrial levels. In Particular, EU leaders agreed a series of ambitious targets at the Spring European Summit in 2007: to reduce their GHG emission by 20 per cent from 1990 levels (or 30 per cent if other industrialised countries join a post-Kyoto agreement); to increase the share of renewable energy in the overall energy supply to 20 per cent by 2020; and to increase the share of biofuels in energy consumed by transport to 10 per cent by 2020. These targets were followed by the agreement by Heads of State and the European Parliament of the 'climate and energy package' of implementing measures in December 2008. In addition the EU is taking a leading role in international climate change negotiations under the framework of the UNFCCC and a post-Kyoto Agreement.

climate change objectives. Similarly, strong support can also be found for climate change spending in relation to the redistribution of the costs of meeting climate change targets: the most cost-effective means for the EU to meet collective European environmental targets may well impose disproportionate burdens on some Member States. For example, maintaining forest cover in the new Member States for the purpose of providing carbon sinks would be a more effective way of reducing emissions than deforestation accompanied by the planting of fuel crops – and would secure additional biodiversity gains at the same time. However, the (substantial) income foregone may need to be offset by compensatory payments from the rest of the EU, in order to establish an incentive. Similarly, the best sites in Europe for establishing renewable energy infrastructures (for example, offshore wind farms or tidal barrages) are unlikely always to be located in Member States that can afford to construct them. This, too, might be an occasion for compensatory payments.

Spending on climate change adaptation has not been a significant feature of the EU budget so far. While the arguments for EU expenditure on adaptation are less strong theoretically, than for mitigation, since spill-over effects are much smaller, there is a case for allocating EU resources in this area. A number of studies show that, although 'net' impacts to Europe may be modest, (eg with respect to agriculture, mortality and energy supply), there is a strong distributional differences between the north and the south. Some of the greatest impacts are to be expected in the poorest parts of Europe (EEA 2007a; Richard *et al* 2008). Therefore there are arguments for EU spending in this area related to the redistribution (of costs) as well as solidarity. Sharing the costs of adaptation may also reinforces the case for action on mitigation in those Member States which are more reluctant to act or face greater resource constraints.

As discussed above, there is room to argue that the EUSF should be applicable to climate change related events or longer term changes especially in relation to adaptation to climate change. It is currently unclear whether the EUSF could be used to address some of the longer-term consequences of climate change. However, there are a number of reasons to think that this might be a justification of spending on climate change in future. The European Parliament has pressed for the definition of 'natural disaster' in Article 2 of the EUSF Regulation (2012/2002) to be extended beyond sudden catastrophic events like floods, to include more protracted threats such as droughts, desertification, or the development of urban 'hot spots' where the elderly and the very young are particularly vulnerable (European Parliament 2006). The Commission's Green Paper on adaptation to climate change also raises the possibility of 'innovative financing arrangements dedicated to adaptation, to support the implementation of co-ordinated adaptation strategies, especially in the most vulnerable regions and sections of society in Europe' (CEC 2007b).

4.2 How much is the EU currently spending on climate change?

4.2.1 Structural and Cohesion Funds

Despite energy efficiency and renewable energy being emphasised as one of the 12 priority areas for Structural Fund investments by the Community Strategic Guidelines for Cohesion 2007-2013 (CEC 2005), it has been estimated that only 10 per cent of Structural Funds are spent on environmental investments which is equivalent to about €3 billion (WWF 2005 in ECORYS 2008).[6] This spending is broader than climate change objectives and includes spending on basic environmental infrastructure to cope with waste

[6] Other figures also exist: Lenschow 2005, 314) finds that 2.5 billion of the Cohesion Funds are spent on environmental policies and Green Alliance state that the Commission has claimed that 30 per cent of Cohesion Funds in 2007-2013 will be beneficial to the environment.

management and water treatment requirements, especially in the new Member States, so the amount of spending on achieving climate change objectives is even lower.

The main concern is that although there is opportunity for climate change related spending in these funds, the guidelines and criteria are remarkably weak from an environmental perspective. When this is coupled with the decentralisation of the management to Member States as well as the 'Lisbonisation'[7] of the Structural Funds, this has resulted in much of the investments being spent on other projects. The main objective of convergence regions[8] is to increase the rate of growth and green investments are not a priority, if not clearly connected to growth enhancing activities. In contrast, road infrastructure and energy intensive industry is clearly a major priority for most convergence regions and in particular new Member States. Obviously, this type of investment undermines the EU's climate change objectives. For example, in the last 2000-2006 Financial Perspective, 17 per cent of total Structural Fund spending was on transport, of which almost 60 per cent was spent on the development of roads. Spending on more sustainable forms of transport infrastructure accounted for a small, if not marginal share of the total. Only 21 per cent was spent on rail networks and a tiny 0.2 per cent on cycle tracks.

Considering this pattern of spending, it is perhaps not surprising that the four Member States which have received the largest share of the spending of the Structural Funds in the last decade (Ireland, Spain, Portugal and Greece) have been at the top of the EU-15 league table in terms of increased GHG emissions (EEA 2007b). Much of this increase has been due to increased demand for energy and transport growth. A report on planned structural spending in the ten new Member States in central and eastern Europe published by FOEE and CEE Bankwatch Network (2007) reveals that these damaging spending patterns are likely to be repeated in the current Financial Perspective in new Member States. The draft Operating Programmes[9] submitted by the central and eastern Member States showed that energy efficiency and renewable energy have each been allocated only one per cent of EU funds (€1.8 billion) while €25 billion is to be spent on roads and motorways compared to €14 billion allocated for railways and €4.8 billion for urban and regional public transport (*ibid*).

4.2.2 Research and development

The current Seventh Framework Programme (FP7) provides €50.5 billion to finance selected research projects during the period 2007-13. Of these funds, €8.35 billion have been allocated to themes which include spending on climate change research. This includes: €1.9 billion allocated for 'Environment and Climate Change'; €2.35 billion for 'Energy' (with a clear focus on clean energy technologies, energy saving technologies and carbon storage technologies); and €4.1 billion for 'Transport' with a focus on technologies reducing emission rates). One estimate puts the *annual* spending of research on environmental-related research as €1.2 billion (ECORYS *et al* 2008). In general, there appears to be an increase in funding for research and a rise in climate related research in particular since the last FP6 (Adelle *et al* 2008). However, the funding for sustainable

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[7] This refers to the increasing support for the Lisbon Strategy for 'growth and jobs' due to the 'earmarking' of 75 per cent of spending.

[8] Convergence regions include 17 of the EU's poorest Member States and 84 regions, with a GDP below 75 per cent of the EU average.

[9] Operational Programmes are the specific funding plans for the Structural and Cohesion Funds. They are drafted by the Member States and submitted to the European Commission, which has the final say on the plans and has the right to ask for modifications before approving them. In 2007 the Commission reviewed and approved nearly 450 Operational Programmes submitted by all Member States.

energy research and development under the FP7 is less than the funding (€2.75 billion) for research into nuclear power under the Euratom R&D Programme (EU Council 2006).

In addition to the FP7, the EU has a separate energy efficiency programme, 'Intelligent Energy Europe within the Competitiveness and innovation Framework Programme (CIP)'. This will provide about €700 million to fund projects that help remove barriers to the market receptiveness and uptake of energy-efficient technologies.

4.3 Other Funds

LIFE+ has only limited ability to contribute to the EU's climate change objectives. First it has only limited resources (€2.14 billion for 2007-2013). Second, much of its focus is on implementing EU legislation in the context of the 6EAP. Third, it also devotes half its funds to its nature and biodiversity component and preserving SPAs and SACs. However, two components of LIFE+ are relevant to pursuing climate change policy objectives: 'Environmental Policy and Governance' and 'Information and Communication'. These include the development of innovative policy approaches, technologies, methods and instruments, but the extent to which they will effectively contribute to the achievement of those objectives will largely depend on the nature of the actual projects submitted and selected for funding.

4.4 What should the EU be spending on climate change?

4.4.1 Structural and Cohesion Funds

The Stern report noted that a properly functioning carbon market is essential to giving the price signals necessary to achieve the transformation to a low carbon economy, but this will not be sufficient because during the transition period of the next 10-20 years 'it is critical that governments consider how to avoid the risks of locking into a high-carbon infrastructure' (Stern 2006). The EU Emissions Trading Scheme (ETS) is the primary instrument designed to create a properly functioning carbon market, but as Stern noted, this does not preclude the need for further public and private investment to avoid the risks of high-carbon infrastructure. A report written for the European Parliament Budgetary Committee estimated that the EU share of the global costs of addressing climate change to be around €60 billion annually (Egenhofer *et al* 2008). While it is not necessary that the EU budget finances all these costs incurred, it may also serve as a catalyst for investments in emissions-curbing actions and technologies. Unfortunately, the discussion above shows that EU Structural and Cohesion Funds have not only failed to contribute in any significant way to addressing climate change, but have played a significant role in locking in high-carbon patterns of energy generation and transport.

Therefore, a shift in investment in the Structural and Cohesion Funds is required. Especially in poorer countries where national budgets are limited and other priorities may take precedent. One way of achieving this shift in investment would be to 'earmark' a certain percentage of these funds for low carbon investments just as occurs in the current funds for achieving the Lisbon Objectives.[10] Egenhofer et al (2008) suggest that creating a budget line or specific sub-heading for investments in mitigation and adaptation is one possible option for the next Financial Perspective (Egenhofer *et al* 2008). It would also be useful to alter the eligibility criteria for projects, requiring that these integrate GHG mitigation actions where relevant.

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[10] This is the so-called 'Lisbonisation' of cohesion policy where 60 per cent of funds under the 'convergence' objective and 75 per cent under the 'regional competitiveness and employment' objective are earmarked for the new Lisbon agenda investments.

Moreover, Green Alliance (2007) suggest that all EU spending under these funds should be ‘climate proofed’ by having to demonstrate how they will contribute to Member States’ national emissions targets and the Commission should have the power to reject all programmes not consistent with these targets. Currently Strategic Environmental Assessments (SEAs) for the Operational Programmes under the Structural Funds are carried out but it has been reported that these are conducted in a hurry and at too late a stage to influence the shape of these programmes. For instance, while most of the SEA reports for transport Operational Programmes do mention the risk of GHG emission increases from road transport, they do not demand any significant changes in the programmes to prevent this risk, such as reallocating the funds towards environmentally friendly modes (FOEE and CEE Bankwatch Network 2007). Greater scrutiny of these SEAs could help to ensure that Member States’ Programmes better match up to the climate change objectives.

The two specific areas which could be targeted (especially within the Cohesion Funds) for greater coherence with climate change objectives are energy efficiency and transport. Energy efficiency is essential for meeting the EU’s climate objectives and one area where Structural Funds could be usefully directed. The building sector accounts for 40 per cent of the EU’s energy requirements and offers the largest single potential for improved energy efficiency. Research shows that more than one-fifth of the present energy consumption and up to 30-45 million tonnes of CO_2 per year could be saved by 2010 by applying more ambitious standards to new and refurbished buildings (CEC 2008c).

The Directive on Energy Performance of Buildings (as well as its recent proposed revision) aims to make public, commercial and private buildings in all Member States more energy efficient. However, there is an example where there is a risk of non-compliance with the legislation if not enough funding is provided to assist those Member States who will require the greater action to reach compliance (see section 6). Energy efficiency improvements can require large up-front investments that only pay off after many years. Therefore, the issue of who provides funding and how best to implement it remains the subject of a complex and far-reaching debate (Euractiv 2007). The EU has a role to play in providing funds for improving energy efficiency, especially in multifamily and social housing in new Member States. These countries currently have the possibility of using EU funds for housing which would allow, even if not stated explicitly, funding of energy efficient housing projects and promoting those using renewable energy sources. However funds are limited to 3 per cent of the ERDF which may discourage energy efficient projects due to material costs. This funding area should be increased and highlighted.

Similarly, a shift in spending is needed in the transport field. Specifically, away from new roads and aviation and into three areas: creation of new low-carbon infrastructure, innovations that reduce the carbon intensity of existing infrastructure, and solutions that reduce the need to travel. A report published by FOEE and CEE Bankwatch Network (2007) suggests that at least 75 per cent of EU transport funding be allocated or earmarked for more environmentally friendly transport investments. Funding could be allocated to new infrastructure spending so as to accelerate the creation of a high-speed rail network in Europe for freight and personal travel. It could, as Green Alliance (2007) suggest, also improve the carbon intensity of existing infrastructure through measures such as car sharing or reducing the need to travel by rolling out broadband communication. Investment could also be made in bicycle lanes and public transport (including improving its rolling stock, frequency, quality, safety and environmental performance).

4.4.2 Research and development

A great deal more investment is needed in research and development in order to decarbonise the European economy. The increased funding allocated to this area in the latest FP7 is a positive step but not enough relative to the enormous and urgent task at hand. A report on th value of EU spending concludes that in relation to climate change, there should be "a substantial increase in the R&D budget" (ECORYS *et al* 2008, 265). The Green Alliance (2007) suggests €7.5-€8.5 billion per year will be needed. This is not to say that EU spending should occur in isolation but to lever additional national public and private funding to fast track low-carbon technologies. It should also be linked to other policy measures that help create markets for new technologies. Key areas for increased R&D in climate change mitigation funding include:

- development and deployment of measurement methodologies and testing procedures to underpin and promote the development of energy performance standards and labelling for an ever-increasing range of products;
- continued focus of R&D on energy-efficient technologies, in particular to facilitate the move to zero-carbon buildings;
- renewable energy generation and systems, particularly smart distribution and decentralisation control systems. Emphasis needs to be placed on better utilisation of all renewable energy sources. Wind power has been explored and is starting to make a difference. However, R&D on wave and tidal technology is required because this is not yet fully understood or utilised.
- a greater emphasis on and investment in non-nuclear energy options in contrast to the current preponderance of research on nuclear options in EU funding.
- on reducing emissions (often non CO_2 gases) from agriculture and the use of biological sequestration.

Funding can also be deployed for the adaptation to climate change, an area which is particularly poorly served by the private sector, for example through:

- Improved monitoring and prediction of climate change impacts, including identification of 'urban hot spots' (often affecting social housing);
- Better modelling of regional impacts, and development and deployment of drought and flood resistant crops.

Besides these suggested increases and shift in focus of EU R&D funding, another high profile area of debate is the funding of the 10-12 Carbon Capture and Storage (CCS) plants that the Commission promised. This debate is currently only loosely connected to the EU budget as the resources under discussion look set to come from outside the EU budget.[11] However, this debate is still worth briefly outlining here. The fate of the auction revenues from the next phase (post-2012) of the ETS has been a controversial topic during 2008 and in particular the potential to use some of these monies to support the development of CCS. In 2007, the Commission made a commitment to the development of 10-12 demonstration projects by 2015 but who and how these would be funded was not decided. The technology is highly expensive, and both public authorities and the private sector had been reluctant to offer the financing necessary to jump start the uptake of CCS on a commercial scale (Euractiv 2008). However, the agreement reached in December 2008 on the climate change and energy package between the EU Heads of State and the

[11] Another funding debate (that is outside the main budget review debate) that it is useful to be aware of is developing around the EU Economic Recovery Plan (COM(2008)800) and the follow up proposed Regulation (COM(2009)35) establishing a programme to aid economic recovery by granting Community assistance to identified strategic energy projects includes a sum of €1.750 million for gas and electricity interconnection projects; €500 million for large-scale offshore wind projects; and €1.250 million for carbon capture and storage demonstration and infrastructure projects.

European Parliament calls for 300 million ETS allowances to be awarded to large scale CCS projects in the EU. The value of this support depends on the price of CO2 at the time, however could approximately amount to between €6 – 9 billion. In addition, Member States declared their 'willingness' to allocate up to 50 per cent of their revenues from ETS allowance auctioning to mitigating climate change. This could translate into a significant investment in clean technology developments such as CCS. However, momentum behind securing funds for this very important technology must be maintained.

4.4.3 Other funds

The small amount of funds allocated to successive LIFE programmes mean that it is unlikely that this fund will be able to develop into a funding instrument that can adequately support the EU's climate change objectives. The increased expenditure required is more likely to continue to be 'mainstreamed' and so funded from the Structural and Cohesion Funds and perhaps from a more environmentally focused CAP (see below). However, since 'mainstreaming' has been shown to be less than effective in meeting the Union's climate change objectives, there are arguments for considering an alternative approach, in particular, the establishment of a dedicated EU Climate Change Fund. This could bring together most of the EU's climate-related spending currently scattered through EU programmes as well as additional funds. However, there are various reasons to be cautious, though not dismissive, of this approach. First, if climate change objectives are not mainstreamed into the major EU spending programmes, then these funds can undermine the EU's climate change objectives and encourage the increase of GHG emissions. The coherence of the EU budget with climate change policy objectives is an important aspect of the EU budget review debate. Second, the lessons learnt from LIFE in terms of its effectiveness and efficiency of spending is not particularly encouraging for the creation of an extra environmental type fund managed by DG Environment (2008).

Solidarity programmes for climate change adaptation in the EUSF could focus on river basement management (strengthening of dykes, creation of flood areas etc) and coastal zone protection (storm barriers, flood barriers). Civil Protection (currently the responsibility of DG Environment) is also related to this issue. If the risk of natural disasters (such as sea floods and forest fires etc) increases due to climate change, it will become more worthwhile to have a Rapid Reaction Force with sufficient capacity in terms of personnel and material (ECORYS *et al* 2008). At the Member State level the risk of such disasters does probably not meet the costs of a professional Rapid Reaction Force. At an EU level this could be different.

4.5 What are the main stakeholders and views in the debate?

Climate change was identified by two thirds of contributors to the EU budget review consultation exercise as a key challenge for the EU in future and it is widely recommended that the EU should increase funding in this area. However, stakeholder support may become less enthusiastic when increased spending on climate change inevitably entails either an increased EU budget or the shifting of spending from other objectives. This is currently the subject of intense political negotiation.

DG Budget has prime responsibility over the development of the Budget proposals and has been the dominant voice within the European Commission so far. However, several other DGs have an obvious interest in this debate, eg DG Regions, DG Agriculture as well as DG Environment and DG Enterprise. While their voices have been conspicuously absent so far in the budget review debate, DG Agriculture and DG Regions are both engaged in separate but linked discussions on the future of their respective policy areas: the CAP and the Cohesion Policy. A shift of spending from rural development to cohesion policy was one of the most controversial issues of the stakeholder workshop on the consultation exercise in November 2008. This may further increase the defensive position of DG Agriculture in the budget review debate.

The European Parliament has a history of attempting to Green the Budget in the 1990s and so could be expected to be supportive of increased spending on climate change in future. The Parliament's Budgets Committee have held a number of hearings in relation to the EU's budget and climate change objectives.

The Member States' official views are available on the Commission's website and show broad support for increased spending on climate change. However, the importance of structural and cohesion spending for new Member States (as well as CAP), and the apparent incoherence of these funds with EU climate change objectives, may lead to a resistance to any change in the budget by new Member States unless they see that they are significantly benefiting economically from new climate change spending. In contrast, the UK position proposes a 'fundamental reform' of the EU budget away from the CAP and towards three priority areas, including climate change (HM Treasury 2008). The UK position was formulated by HM Treasury and diverges from the positions of some individual departments and government agencies.

Support for increased spending on climate change in the consultation has also come from green NGOs and groups including, Birdlife International, CEE Bankwatch Network, E3G Third Generation Environmentalism, Friends of the earth Europe; Green 10; Green Alliance, Green Budget Forum. These submissions remained mainly general in their recommendations, in keeping with the debate so far.

5 COMMON AGRICULTURAL POLICY

5.1 Why spend on sustainable agricultural management?

The dual challenges of mitigating and adapting to climate change and achieving biodiversity protection will dominate the environmental agenda in the immediate future. The case for intervention on climate is now fairly comprehensive, with discussions turning to the effectiveness of different approaches, including the role that the land use sectors will play in a post-Kyoto agreement. Given that targets to halt the loss of biodiversity by 2010 are unlikely to be met, the case for prioritising biodiversity objectives is also compelling. These targets may be even more difficult to achieve in the future given the likelihood of trade-offs in relation to the pursuit of other objectives such as climate change reduction and mitigation, bioenergy production and the production of sufficient, safe and high quality food.

Agriculture accounts for just under 50 per cent of Europe's land area, and given the extent of this territorial dominance, its environmental impact is significant. Depending on the type of management practiced, farming can produce both positive and negative environmental externalities (OECD, 2001). Especially in the last century, technical and structural change in farming have led to detrimental impacts such as soil erosion, water pollution, loss of biodiversity and a decline in landscape character, as captured by a range of indicators that measure the environmental impacts of agriculture (EEA, 2005; 2007; OECD, 2008). Furthermore, the impact of EU agriculture on climate change is substantial, with EU agriculture contributing on average 9 per cent to total greenhouse gas (GHG) emissions, rising to 14 per cent in countries such as France.

Agricultural production in the EU also gives rise to a wide range of environmental benefits, including farmland biodiversity, valued cultural landscapes, ecosystem resilience to support climate change adaptation, as well as the potential to contribute to climate change mitigation, through fossil fuel substitution and carbon sequestration. As such, it has a critical role to play in addressing some of the environmental challenges Europe faces, but its capacity to do so depends on the continuation of sustainable management practices, including extensive practices which support biodiversity (Beaufoy *et al*., 1994), and those that maintain existing stocks of carbon in soils with a high organic carbon content, including the avoidance of inappropriate land use change (Climsoil, 2008). The centrality of agriculture's potential role in responding to environmental priorities is further reinforced by the fact that the CAP provides an existing policy infrastructure and a suite of instruments with the potential to deliver environmental benefits under the right conditions.

While many of these environmental benefits have been provided either incidentally or as a result of philanthropic behaviour on the part of certain individuals, this does not guarantee their ongoing provision. High commodity prices, which are likely to set to continue for at least several years to come - not withstanding the impacts of the current recession - have provided a stimulus for production in a market oriented sector with demand for bioenergy and biofuel feedstocks, high demand for cereals from India and China, and a scarcity of new agricultural land, causing an upward pressure on agricultural and food prices (DG Agriculture, 2008; World Bank, 2008; OECD-FAO, 2007). For the most part, farmers will organise their production to maximise profit and will respond to these market signals for food and other saleable outputs by intensifying production, and in so doing, will pay less attention to the impact of their activities on biodiversity and landscape for which there are no functioning markets. Under these circumstances, the opportunity costs of the provision of these public benefits increases, leading - in the absence of some form of intervention and accompanying programme of expenditure - to a contraction in the stock of these benefits, with the potential for increased scarcity in the future. The need to secure these environmental goods and services in line with a growth in expressed or prospective public demand provides a central challenge for future agricultural policy and underpins the case for spending on sustainable land management.

There are a range of policy instruments with the potential to steer sustainable land management, including regulation, market based instruments or incentive based measures where the taxpayer purchases environmental services through subsidies to private owners or direct interventions (Slee, 2007). All instruments have a role to play, although the relevance of each depends in part on the distribution of costs and on whom these should fall – whether on private land managers or on the public purse – in line with the Polluter Pays Principle (Article 130r(2) of the Treaty of Amsterdam (1997)).

EU environmental legislation, for example, plays a clear role in minimising some of the negative externalities of agriculture, by stipulating that certain standards laid down by society are respected and that the owner or controller of the resources internalises any of the costs involved. While it is possible to steer sustainable land management through mandatory standards, this however, can only yield limited results and it is difficult to regulate certain benefits into existence. Delivering more through mandatory standards, as through the proposed new GAEC standards in England, may be appropriate, but perhaps only where land management is profitable and can absorb any additional costs. Conversely, many of the types of farming systems with which most public benefits are associated – notably HNV farming systems – are not profitable, and therefore it is problematic to expose them to an additional regulatory burden.

In the absence of targeted payments for environmental services which adequately remunerate farmers for opportunity costs and income foregone, the incidental provision of environmental benefits will contract. It is clear, therefore, that above the mandatory baseline, an incentive of some kind is required to support a type of management activity which imposes additional restrictions on property rights. This raises some challenging questions for policy. It requires addressing the causes of market and government failure, data needs to assess the stock and flow of environmental services and benefits, the challenge of targeting payments and the delivery of benefits without escalating transaction costs, ensuring adequate administrative capacity and advice, and the challenge of enforcement, and monitoring and evaluation. In the next section, we discuss the funds available for sustainable land management at the EU level, and the extent to which they are being used efficiently to deliver beneficial results. In the recommendations, we reflect on the appropriateness of EU level spending.

5.2 What is currently spent on sustainable land management at the EU level?

Expenditure on the CAP falls under the 'Natural Resources' heading of the EU budget and for the current financial perspective, accounts for 41 per cent of the total. Albeit with a much smaller budget, the LIFE fund, which currently accounts for 0.2 per cent of the EU budget (€2.14 billion for the period 2007-2013), and parts of the Structural Funds may also be used to support sustainable land management.

The total EU budget for the CAP for the period 2007-13 is €374 billion, of which approximately 80 per cent (€295 billion) is allocated to Pillar One, and 20 per cent (€79 billion) to Pillar Two (excluding national co-financing and before modulation). As an average across the EU-27 Member States, the Pillar One budget is four times the size of Pillar Two, however, this masks considerable differences between the new and old Member States. In the EU-15 Member States, Pillar One is allocated five times more than Pillar Two, whereas in the EU-12 Member States, the budget for both Pillars is relatively even.

The proportion of funds allocated to Pillar Two has increased significantly over time. Indeed, at the start of the previous programming period, Pillar Two accounted for only 10 per cent of the total CAP budget (Dwyer et al., 2002). The introduction of compulsory modulation has further altered the balance between the two Pillars, and with recent increases in the rate of modulation agreed as part of the CAP Health Check negotiations, this will result in a transfer of approximately €12 billion from Pillar One to Pillar Two[12]. National co-financing is required for all Pillar Two expenditure, and this increases the budget available for Pillar Two by a further €58 billion over the 2007-13 period, leading to a total budget for Pillar Two for the 2007-13 period of €149 billion. When national co-financing is taken into account, the ratio between the two Pillars for the EU-27 is 2:1.

Within Pillar Two, a range of measures can contribute to sustainable land management. The most significant measures sit within Axis 2, the objective of which is 'improving the environment and countryside'. Measures such as the agri-environment measure (the only measure that is compulsory for all Member States to implement), the 'natural handicaps' measures, measures focused at securing appropriate management within Natura 2000 areas, and a range of forestry measures fall within this Axis. Axis 2 accounts for 44 per cent of the Pillar Two budget (excluding national co-financing), with 51 per cent of this allocated to the agri-environment measures, and a further 32 percent to natural handicap payments within Less Favoured Areas.

However, measures within other Axes can also contribute to sustainable land management, most notably the farm modernisation and advice and training measures

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[12] This includes the amount raised by the higher rates of modulation agreed under the Health Check in November 2008, which amounts to an additional €3.24 billion between 2010 and 2013. These figures do not include additional national co-financing.

under Axis 1, and a number of the Axis 3 measures focused on the diversification of the rural economy, and those encouraging the development of new businesses and services in rural areas. In particular, the farm modernisation measure within Axis 1 has been used in some Member States for modernising livestock housing, improving silage storage, improving equipment for the spreading of animal wastes, investments in renewable energy infrastructure, with benefits for water quality and helping to reduce greenhouse gas emissions. The advice and training measure in France, for example, has been used to introduce training programmes on more efficient fertiliser use. Axis 1 accounts for 34 per cent of the Pillar Two budget, with 31 per cent allocated to the farm modernisation measure. Axis 3, in comparison accounts for 13 percent of the Pillar Two budget.

LIFE + is the only fund dedicated solely to the environment. Expenditure under LIFE+ (and its predecessors) is an important element in the implementation of the Habitats and Birds Directive, especially the establishment and management of the Natura 2000 network. Projects funded have focused on a range of issues relating to sustainable land management, including soil and water protection; improved irrigation techniques; pest control; waste management; landscape protection; as well as tackling climate change mitigation, through the development of innovative policy approaches, technologies, methods and instruments (DG Environment, 2008). The extent to which these projects effectively contribute to the achievement of environmental objectives, however, largely depends on the nature of the actual projects submitted and selected for funding (IEEP, 2009). It is recognised that funding under the LIFE programme is insufficient to support the ongoing management of the Natura network, for example, however, it is intended that additional funding should be provided through the CAP (Pillar Two) as well as the Structural Funds.

5.3 How can this be improved?

There is evidence to suggest that sustainable land management and the delivery of environmental benefits can be more effectively achieved through a more focused and targeted approach than through non targeted forms of support (see, for example, Swinnen, 2009; House of Lords, 2008; Núñez Ferrer and Kaditi, 2007). The 'programming' approach of Pillar 2 – characterised by the setting of strategic community priorities, clear objectives tied to local needs, detailed measures with criteria for use, targeted payments, provisions for advisory support and capacity-building, monitoring and evaluation, as well as reporting procedures to establish whether or not needs are being met – make this an appropriate policy framework for delivering the often highly contractualised form of intervention needed to achieve environmental outcomes.

This underpins an argument for an accelerated transfer of money from Pillar One to Pillar Two of the CAP, whilst at the same time, ensuring the more environmentally-sensitive targeting of direct payments in the immediate future. The recent announcement by France to alter the focus and distribution of a proportion of Pillar One direct payments in 2010 to channel support away from intensive arable producers towards the livestock sector provides a potential model - albeit a conservative one - of targeting Pillar One support at the providers of environmental benefits (IEEP, 2009).

Whilst Pillar Two provides an effective policy framework in theory, it is not a panacea. There is evidence that certain Axis 2 measures, including agri-environment in particular, deliver a range of positive environmental outcomes (for example for soils, biodiversity, water and landscape) (Kleijn *et al*, 2006; Oréade Brèche, 2005), and climate objectives, if properly designed and implemented. However, evaluations of the 2000 – 2006 and 2007 – 2013 rural development programmes are sometimes inconclusive in terms of their effectiveness in meeting stated objectives. Assessing the impact of policy measures on the environment is notoriously difficult, given the availability of data at the appropriate scale, and the complexity of the causality between interventions and land management, and in turn environmental outcomes.

The potential of Pillar Two to deliver sustainable land management and complex environmental outcomes is not always realised for a number of reasons. Not all money within Pillar Two is targeted on sustainable land management, with significant funds diverted into Axis 1, especially in the new Member States where most funds are allocated to accelerating agricultural restructuring. Even where money is spent on Axis 2 measures, such as the agri-environment measure, the intensity of spending under this measure varies across Member States. For example, the rate of expenditure for six Spanish regions, France and Romania falls below €10/hectare UAA per year (Farmer *et al*., 2008) providing a clear disincentive to uptake.

An inherently voluntary and piecemeal approach of agri-environment is one of the greatest barriers to delivering environmental public benefits, coupled with an insufficient overall budget, and low payment rates per hectare. Targeted, collaborative efforts at landscape scale (Farmer *et al*., 2008), with expert advice for farmers, are key factors for success and even then it is likely that beneficial effects will not be manifest for some time. Even if the impacts of rural development measures are not overwhelmingly positive at the present time, this is not a long established policy, and hasty assessments should be avoided. A considerable commitment of time and resources is needed to enable adequate capacity building and training, both of beneficiaries and those delivering the programmes, and many environmental outcomes take time to manifest themselves. It will be strategically important to maintain reasoned faith in the potential of rural development policy to deliver sustainable land management and environmental benefits, for there is a clear policy framework in place, along with some proven instruments which combine a highly contractualist (AE), with a less targeted approach (LFA measure). Alternative approaches to incentivising land managers are difficult to identify at present.

5.4 Who are the main stakeholders and views in the debate?

A range of stakeholders are emerging as forerunner in the debate surrounding the future of the CAP, through the publication of vision documents and think pieces. To date, environmental stakeholders, such as Birdlife International and Wildlife and Countryside Link, alongside farming organisations, such as ELO and Copa Cogeca, and the think tank Notre Europe, are amongst those that are leading the debate and seeking to develop a new justification, direction and focus for the CAP. The discussion appears to be coalescing around two core arguments, which are often advocated as being mutually reinforcing. These are the twin debates of ‘food security’ and ‘environmental security’.

The UK and Dutch Governments have been the most vocal to date on their views about the future direction of the CAP specifically, in terms of the publications of specific position papers, although all Member States have submitted responses to the consultation on the Budget Review, many of which touch upon the need for, and likelihood of further CAP reform. Sweden and the UK, unsurprisingly, are strong supporters of substantial reform, but as part of a broader strategy to significantly reduce CAP expenditure and redirect this funding to pursue other priorities, such as meeting the challenge of climate change (IEEP, 2008). Others, for example Estonia, Denmark and Portugal, argue that any reductions in Pillar One funds should be redirected into Pillar Two. A rather larger group of Member States are also in favour of increasing the Pillar Two budget but have not yet articulated where this increase in resources should come from. However, a common theme in many of these responses is the need for funding to be focused on sustainable rural development and the rewarding of public goods and services that go beyond the legal baseline. The

French proposals, put forward at the end of February, also focus on the need to move towards a system of support for farmers that is 'fairer, more sustainable, more precautionary and more balanced' and 'economically, ecologically and territorially legitimate'.

6 IMPLEMENTATION OF EU ENVIRONMENTAL LEGISLATION

6.1 Why spend on implementation?

The main argument for spending EU money on the implementation of EU environmental legislation is that of using the 'best policy instrument'. However, the delivery of environmental objectives can often be more effectively achieved through the use of a mix of complementary policy instruments rather than a single 'best instrument' as there can be many potential linkages and synergies amongst policy instruments (Gouldson *et al* 2008).

This policy mix is particularly appropriate in the context of the recent 'governance turn' in EU (environmental) policy. In its White Paper on Governance in 2000, the European Commission signalled its intention to make greater use of 'softer' policy instruments in future including voluntary agreements, Market-Based Instruments and the Open Method of Coordination. These types of instruments aim to involve a wider group of stakeholders into their design and implementation and stand in contrast to the traditional 'hard' top-down approach of regulation by central government (or in this case the EU). In addition to the use of these 'New Environmental Policy Instruments' (Jordan *et al* 2003), this new 'governance' approach has also increasing used Framework Directives rather than other forms of legislation. These set out the broad objectives and legally binding rules but leave the detailed implementation to be worked out in other contexts, usually relying on involvement of non-state regional and local actors such as agencies within Member States. The implementation of these Framework Directives therefore requires the further use of policy instruments on the ground. In addition, while in theory EU regulation (either Framework Directives or more traditional forms of legislation) legally binds Member States to comply with its provisions, there is an acknowledged implementation deficit in EU environmental legislation in practice which can necessitate the use of additional policy instruments to achieve the desired policy objective.

Funding instruments in particular can assist in the implementation (and so policy effectiveness) of environmental regulations by providing extra incentives to Member States to comply in a number of circumstances. For example, when a policy is just not considered a priority due to differences in cultural values or where they simply do not have enough resources to make this policy a priority. There is already provision within the Cohesion Fund to assist poorer Member states comply with basic environmental legislation mainly through the construction of environmental infrastructure to deal with water and waste issues (ie so also contributing to the main cohesion objective of these funds). In addition, funding can be used as an incentive to ensure that Member States cooperate across borders where necessary eg in the design and management of international river basins in the Water Framework Directive (WFD).

While it is possible to argue that the necessary funding for these measures could be provided by national governments, there is also an argument for EU level funding to enhance policy effectiveness, especially in poorer Member States, using the principles of subsidiarity, redistribution and EU public goods. Since water pollution is a shared problem where many Member States have an interest, especially in the case of river basins which cross national borders, there is a clear collective environmental benefit which would be greater than the outcome achieved by Member States acting alone, ie subsidiarity. Therefore, EU funding provides a means of securing higher environmental standards, ie EU public goods, at the level of the 27 Member States. In situations where poorer countries would not be able to comply with EU environmental legislation without this assistance there is an argument to provide funding (ie strings attached to funds redistributing EU benefits) in order to secure a better European outcome. It is also possible to compensate countries which take on more than their share of the economic burden for the good of their neighbours or the EU as a whole (ie redistribution of costs).

6.2 What is currently spent on implementation and how can this be improved?

Since environmental spending is mainstreamed it is difficult to ascertain how much is spent on implementing EU environmental legislation, just as it is for reaching climate change objectives. 78 per cent of LIFE+ funding is for co-financing environmental projects in Member States including the protection of Natura 2000 sites (which in part implement the Birds and Habitats Directives). Similarly, the Commission claim that 30 per cent of the Cohesion Funds are spent on environmental objectives including the implementation of environmental legislation (mainly through environmental infrastructure projects). In addition, there is opportunity in the Structural Funds for Member States to include programmes relating to the protection of Natura 2000 sites and to implement the Directive on Energy Performance of Buildings (as discussed above). Therefore, while it is difficult to assess the actual EU spending on the implementation of EU environmental legislation, it is possible to identify some policy areas where there are opportunities which could be enhanced: namely, the WFD; the Floods Directive; and Natura 2000.

The WFD was hailed as a new approach to EU environmental policy making. It establishes a common EU approach to protecting, and setting environmental objectives for all ground waters and surface waters while also giving actors at national regional and catchment scales some freedom to explore different ways to meet these objectives. More particularly the Directive requires that statutory management plans are produced for each River Basin District which set out how the objectives for all the water bodies within each river basin are to be achieved. What is innovative is an inherent flexibility which allows these measures to be implemented at different levels, from the national to the local and which allows a combination of predominately regulatory measures and supplementary (mainly non-regulatory) measures to be adopted. A paper by Gouldson *et al* (2008) argues that one of the important types of complementary measures is demonstration projects and knowledge diffusion. Demonstration projects seek to show the feasibility of new technologies or techniques and to raise awareness or reduce the risk and uncertainty for potential participants or users. These projects enable target groups to learn from other actors' experiences and encourages the adoption of new technologies because the costs and risks are reduced through such projects. The research also identified a number of other forms of support and capacity building mechanisms for the implementation of this Directive including subsidies and grants to develop better performance and management and initiatives designed to bring together different actors to exchange information and encourage collaboration.

Similarly, EU funding maybe necessary to ensure the effective implementation of the recent, Floods Directive (2007/60/EC) which is to be carried out in coordination with the WFD. This Directive came into force at the EU level in November 2007 and is currently being transposed in Member States. Its aim is to reduce and manage the risks that floods pose to human health, the environment, cultural heritage and economic activity. The Directive requires Member States to carry out a preliminary assessment by 2011 to identify the river basins and associated coastal areas at risk of flooding. For such zones they would then need to draw up flood risk maps by 2013 and establish flood risk management plans focused on prevention, protection and preparedness by 2015. The Directive applies to inland waters as well as all coastal waters across the whole territory of the EU. EU funds may be needed to assist in the assessment and planning activities, especially in poorer Member States as well as to overcome barriers in the case of international river basins of costal areas. In addition, as in the case of the WFD, implementation of the plans will then require the use of further policy instruments where the use of incentives could be more effective than legislation to ensure best practice or the deployment of helpful technologies etc.

The implementation of the Habitats Directive (92/43/EEC) is also in great need of EU funding to ensure the implementation of the Natura 2000 sites through which it aims contribute towards the maintenance of biodiversity within the EU. In addition, Article 9 of the Habitats Directive provides for the possibility of compensation for disproportionate costs of managing Natura 2000 sites (ie the redistribution of costs). The cost of Natura 2000 for the EU-25 in 2004 was estimated at €6.1 billion per year (WWF 2009). Since then two more Member States have joined the EU, other Natura 2000 land sites have been added while the designation of marine sites has yet to be completed.[13]

The current Financial Perspective opened opportunities for co-financing of biodiversity including Natura 2000 under the European Agriculture Fund for Rural Development, the Structural and Cohesion Funds, LIFE+, the FP7. However, this is far from adequate. LIFE+ is far too small (around 0.2 per cent of the EU budget). 40 per cent of the 2.1 billion for seven years is for biodiversity (including Natura 2000 sites) but has a 50 per cent co-financing rate which makes it difficult for small organisations to access the funds. The Natura 2000 payments under the EAFRD amount only to around €600 million, while around €2.7 billion of the Structural Funds has been allocated towards the promotion of biodiversity and nature protection in the current Financial Perspective. Therefore, while opportunities exist for Member States to include Natura 2000 sites in their Operational Programmes, these have not been widely taken up. National provision of funding towards these sites is variable and on the whole the required funding has not been forthcoming. While the mainstreaming of funding for Natura 2000 is not necessarily a bad idea, opportunities must be reflected in national and regional Operational Programmes for the use of EU funds.

6.3 What are the main stakeholders and views in the debate?

This implementation debate has not been one of the main focuses of the budget review debate so far. However, it has been implicitly mentioned by a number of stakeholders. For example, the importance of EU spending in relation to the implementation of climate change policy and in particular the implementation of the Energy Performance of Buildings Directive has been raised by commentators on climate change spending eg FOEE and CEE Bankwatch Network 2007. In addition, WWF is a keen supporter of increased take up of EU funding for the implementation of the Natura 2000 network. Within the UK, the Land Use Policy Group (LUPG) have shown an interest in which are the most effective policy to deliver certain environmental objectives including the use of funding instruments for the effective implementation of EU legislation. While we feel that the arguments for EU spending to enhance the effectiveness of certain items of EU legislation are significant, it is anticipated that considerable resistance may be encountered from the UK Treasury who are likely to argue that Member States should pay to ensure a high level of compliance themselves.

[13] Financial support for marine biodiversity is by definition unavailable through the Structural and Rural Development Funds.

7 CONCLUSIONS AND RECOMMENDATIONS

7.1 Key issues in the debate

It is clear that current spending on environmental priorities is inadequate and that the budget review is a clear opportunity to address this. In particular, tensions between Lisbon objectives and sustainable development objectives are prevalent. Large, multi-purpose funds, such as the Structural Funds, necessarily have blurred objectives, and for that reason are not proving effective in advancing environmental priorities of the EU. Seeking to mainstream the environment through EU financial instruments established for other purposes means that environmental priorities, including those of the Environment Agency such as climate change and resource management, are unlikely to be completely reflected in the priorities of national strategies or individual Operational Programmes. Member States are more likely to give priority to the economic and competitiveness objectives. Therefore, greater allocation of funding and safe guards must be incorporated into the funding instruments and the architecture of a future EU budget to ensure that environmental priorities receive the level of EU funds they require.

The two key issues of interest high on the budget review debate agenda are spending on CAP and climate change mitigation and to a lesser extent adaptation. However, it is important that spending on other issues related to the environment, especially with regards to the support of the implementation of EU environmental legislation, are also given some profile. While increased spending on climate change is popular and indeed likely, the extent of this increase is unclear and how it will be measure against the estimate €60 bn annually which the EU will need to spend on climate change. Perhaps the largest danger in the budget review debate is the extent to which Pillar 1 of the CAP will be reduced rather than rechannelled to Pillar 2, including increased environmental spending and to what extent - if any - rural spending may be transferred from Pillar 2 to cohesion spending.

7.2 The next steps in the EU budget review

Following the conclusion of the stakeholder consultation in November, the Commission is now drafting a White Paper on budgetary reform which is expected to be published in October of this year but the exact timing is still unclear. While originally scheduled for spring 2009, the timing is now argued to depend on the 'best political window of opportunity'. According to the Budget Commissioner, the European Parliament elections next June, as well as the nomination of the new Commission over the summer and a potential second Irish referendum on the Lisbon Treaty in October (or June?) this year all influence the timing of this paper. The Commission has stated its intention to present three options for reform ranging from less to more radical. This format enables the Commission to present a breadth of options without having to make difficult decisions on the appropriateness and political acceptability of each. Such decisions will fall on the Council and the European Parliament over the course of 2010 and 2011.

A provisional, and somewhat speculative, timetable for the budget review is as follows:

- *June 2009:* Elections to the European Parliament
- *July 2009:* New Commissioners (and President) nominated
- *October 2009*: Second Irish referendum on EU Treaty (the date for this has not been set and is also rumoured to take place in June)
- *October (last week) 2009:* Commission publish White Paper on the budget review.
- *January 2010*: Formal installation of new Commission. Mid-term evaluations of all EU spending programmes ongoing until September.

- *March 2010*: European Parliament Budget Committee seeks to use mid-term reviews to make changes to spending programmes 2011-2013.
- *Autumn 2010*: EP Budget Committee draft report on White Paper. European Council debate on budget review.
- *July 2011*: Deadline for Commission proposals for Financial Perspective commencing in 2013.

Since the consultation period is now officially over, the time to feed into the Commission's initial proposals is perhaps largely drawing to an end. However, there is still a significant amount of time to feed into the debate through the European Parliament and the European Council. From a UK perspective, the UK Treasury are obviously the main gate keepers to the official UK position but this is not to say that other key players could not prove useful.

7.3 Potential policy principles for the Environment Agency

Section 3 of this report highlighted the main theoretical principles that were being used in the budget debate to justify EU spending. These included: the three 'Balls Principles' of the UK Treasury (value-added, best policy instrument, and sound financial management); subsidiarity; redistribution; solidarity; and public goods. Another principle, that of 'juste retour', which has in the past dominated EU budget allocations, was also set out. The question therefore arises as to which ones should the Environment Agency use in its own set of principles to guide it in its approach to the EU budget review?

As discussed above, these principles are not mutually exclusive and even complementary 'sets' of principles such as those of the UK Treasury, usually hide a number of sub principles underneath. Therefore, it is possible to take a pragmatic approach to the use of principles and consider them as a tool kit from which to select the best argument for the policy objectives of the Environment Agency, while at the same time using the applicability of these principles to the policy objectives to gauge the merit of the case being constructed.

However, in general and in accordance to the HM Treasury's principles, to form a convincing argument it is necessary to first make a case for EU value added. This is not just a case for public intervention of any kind (ie that it is a policy problem which needs to be addressed), but that the problem is best suited to *EU level* intervention. This case can be constructed using the principles of subsidiarity, public goods, etc. Only after a case has been made for EU level intervention is it fruitful to go on to make a case for *funding* being a suitable policy instrument (but not necessarily the best policy instrument in the case of funding as a complementary policy instrument) to achieve the desired policy objective in the most effective and efficient manner. Rather than 'sound financial management', which is an issue of public administration reform and largely a separate debate to the main policy priorities in the EU budget review debate, a third principle of the Environment Agency might be, the 'political and practical feasibility' of pursuing the objective. For example, whether other stakeholders are engaged in the same issue or the level of novelty and controversy likely to surround the proposed reform.

7.4 Recommendations

7.4.1 Recommendations for climate change

There is a sharp contrast between the significance of the climate and energy issues on the European agenda and the resources devoted to these topics in the EU budget. Expenditure on climate change measures in the current EU budget is rather modest and at times spending on other objectives serves to undermine EU climate change objectives.

This low level of spending raises questions about the capacity to simultaneously implement an ambitious package of domestic measures and take the lead in international negotiations for a new climate deal. As in other areas of policy, it is a goal of climate policy to meet the growing list of objectives as efficiently as possible, minimizing costs to society along the way. To a considerable degree, objectives can be met using other policy instruments such as regulation, market-based instruments and voluntary agreements. However, it is argued here that these mechanisms alone cannot be relied on to be effective and that EU expenditure will be needed on a larger scale than anticipated to maintain the rate of progress needed to meet highly ambitious goals. Whilst there may be a reluctance to commit public funds until market mechanisms have been fully explored, the time constraints are severe and investment flows may be reduced considerably by the combined impact of the credit crunch and the recession. While at the same time the economic stimulus packages being developed by the EU and individual Member States offer fresh opportunities for spending outside of the EU budget which both contribute and undermine climate change objectives.

Possible priorities in the EU budget review debate for the Environment Agency include:

- Increased spending on R&D and technology transfer both within the next framework programme for research and technological development (FP8) but also in funds such as IEE under the CIP and the very ambitious funding of CCS outside of these funds.
- The better targeting of Structural Funds through changes to the strategic guidelines and/or greater central control of the Operational Programmes of Member States to ensure that opportunities to spend on green energy and transport projects are taken up. More radically a percentage of the Structural Funds could be 'earmarked' for climate change just as occurs for the Lisbon Objectives and/or all spending could be 'climate proofed' through better scrutiny of the SEAs.
- The use of an increased EUSF, and other funds, for funding adaptation costs within the EU.

A more radical priority would be for the creation of a climate change 'transitional' fund which would be set up from funds from the EU budget, Member States and ETS auction revenues as well as some other miscellaneous funds which work in concert with the EIB which are in evidence at the moment such as EU budget under-spend and money from economic stimulus packages. This fund would by pass some of the inbuilt conservancy of the EU budget priorities while providing an instrument capable of concentrating on one policy objective for a limited period of time when action was most needed ie before a suitable carbon market was created world wide. This idea has some support amongst green NGOs and think tanks in the UK.

7.4.2 Recommendations for the CAP

In pursuing a new framework and direction for European policy on agriculture and rural service provision, it is essential to consider how far policy should be advanced though an EU process and central budget and how far through the national or more regional level. Indeed, the real functional challenge is not to determine whether agricultural policy should be intrinsically European or national, but rather how to organise - in an efficient manner - the overlapping involvement of different governmental tiers and how best to coordinate central and local interventions. This is a highly political debate and the views of different actors are deeply coloured by self interest and budget share.

A number of arguments can be advanced for continuing to pursue a European agricultural policy rather than reverting to a nationally determined approach.

- The legal framework within which land managers in the EU provide public benefits, including many of the formal objectives, such as preventing the loss of biodiversity, is set largely at the EU level. Obligations to reduce greenhouse gas emissions are shared at a European level between Member States, even where there are differences in national targets.

- These shared goals and obligations point to a coordinated response within a framework that pursues European as well as more local goals, and which seeks progress at a continental scale.

- With a shift in focus to the provision of public benefits there are strong arguments for pooling financial support so that goals can be pursued efficiently at a European scale. The distribution of suppliers will not be uniform in Europe. The budget should reflect the distribution of supply and allow the pursuit of options which are cost efficient as well as effective at a European scale. This is the strongest argument for a centralised EU budget for a new CAP although it does assume a different distribution of expenditure compared to today.

The Environment Agency should consider how far its objectives for sustainable land and resource management are likely to depend on incentives for land managers in future. In such an analysis GAEC standards, for example for soils, need to be considered as dependent on the provision of incentives at some level. Insofar as it is necessary to incentivise managers rather than pursue a regulatory or market based route then the need for continued funding is clear. For reasons rehearsed above, this funding is more likely to be available from EU sources than national ones, particularly after 2013 when the payback for the current government levels of expenditure on stimulating the economy will start to bite. At a European level the transformation of at least a larger part of the CAP into a sustainable land management fund is more plausible than the creation of a new fund.

Assuming there is a need for continuing incentive payments then the case for transforming the CAP rather than allowing it to be pared back is a strong one. If this analysis is accepted, the EA should temper criticisms of the CAP with arguments that substantial expenditure will be required to meet the expanding set of land management objectives in Europe and that defence of the budget is necessary given the pressures on it.

At a more specific level, consideration should be given to the different land management challenges, such as reducing diffuse water pollution, flood management, improved soil quality, carbon sequestration, better nitrogen cycle management, reversing the decline of biodiversity etc. In each case there are different policy requirements, including the use of incentives, cross compliance, investment aid, research and development and greater education and information provision. The EA should consider these challenges and how far measures available under the CAP may help to deliver objectives. Different pictures may emerge for different environmental concerns. This may help to build a position which allows more precise comments on the role of Pillar 2, Pillar 1 and new formulations which may arise in the coming debate.

Contact should be made with other agencies and other Member States to compare different practices and perspectives and consider joint initiatives once the Commission's proposals appear.

7.4.3 Recommendations for the implementation of environmental legislation

This report has highlighted just a few of the policy areas where EU funding could greatly assist in implementation of the primary policy instrument – EU legislation – namely: the Energy Performance of Buildings Directive; the WFD; the Floods Directive; and Natura 2000. This is an area of the debate which is not currently being articulated fully and is not receiving the high profile that sexier issues such as climate change. Indeed there is a danger that the importance of climate change is leading to the eclipse of other environmental issues not just in the EU budget debate but in the business of governance in general. However, this is clearly a very important issue which should be a feature of the debate. In any case it is closely linked to the other areas of environmental concern in this debate, namely climate change and the CAP. Some of the recommendations for these two other sections also apply to this topic. Foe example, any changes in the Structural Funds targeting could not only ensure adequate funding for programmes and projects addressing climate change but also for those implementing the WFD and the Floods Directives etc. Similarly some of the increased Pillar 2 funds could also be channelled towards these activities. However, it may be necessary to conduct further research to better highlight where the current opportunities and spending for implementing these areas of EU environmental policy are and what barriers are in place to prevent the further provision of funding. Unlike for climate change and the CAP very little research currently exists exploring this aspect of the EU budget. There are however a number of possible allies in this possible policy priority not in the least the Environment Agencies in other Member States as well as NGOs such as WWF and RSPB and groups such as LUPG.

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