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How green is the EU budget and recovery deal?

Climate expenditures have been increased and this gives a clear signal to the private sector: the green transition is here to stay. It remains to be seen, however, how much private money can be attracted so that the emissions reduction target can be reached

There is a deal

After long and difficult negotiations, EU leaders secured a deal on the multi-annual budget and recovery plan. The multiannual budget is worth €1.074 trillion for 2021-2027, while the recovery fund, the Next Generation EU, remained at €750 billion (in 2018 prices) for 2021-2024.

The deal is, however, not completely final, as the European parliament has to approve the multiannual budget. Some members of parliament, such as Manfred Weber, the leader of the centre-right People's party, already said the deal lacks ambition and does not deliver on its priorities. Negotiations will be held over the summer.

As for the Next Generation EU, parliament has no veto but some Members of Parliament have demanded a role in the governance of it. This could be seen as the price for approving the budget deal.

The final deal should generate more green expenditures than the initial proposal and previous budgets

The main sticking point in the negotiations was the proposal for the EU to borrow money directly on financial markets which would then be handed to member states. Climate action was not one of the more controversial themes. Compared to the European Commission's proposal, some green programmes were reduced, but the money that should flow to the green transition has actually increased.

A simple calculation shows that the final deal should generate more green expenditure than the proposal from the European Commission. In the proposal, the spending target for climate action was 25%. In the final deal, this rose to at least 30%. So the final deal should generate about €547 billion of green expenditure (30% of €1.824), while in the proposal this was *only* €463 billion (25% of €1.850). This implies €85 billion of extra green expenditure.

In the new budget and recovery plan, spending on green projects is three times higher than it was under the previous multiannual budget (2014-2020). The EU planned to spend 20% of its last budget on green expenditures, or about €182 billion (20% of €908 billion) and according to the Commission, it is on track to reach 19.7% of that target.

A measurement issue

There is, however, evidence that the existing methodology to track climate spending overstates it. In particular, spending related to the Common Agricultural Programme. But the Commission is aware of this and has pledged to develop an effective methodology for monitoring climate spending and its performance. They will also report on climate expenditures on an annual basis.

As the climate target is now much higher than before and the measurement should also be more stringent, reaching the target will be difficult. It remains to be seen exactly how Europe will reach this objective.

Private sector investment is crucial

Currently, the EU wants to reduce greenhouse gas emissions by 40% by 2030 compared to 1990 levels. And to reach this target, there is a lot of investment needed. In the green deal, published at the end of 2019, the European Commission assumed there was an investment gap of €260 billion per year by 2030. Government action alone is therefore not enough and attracting the private sector is crucial.

Moreover, the target of a 40% reduction is likely to increase. President Ursula von der Leyen already said she wanted to raise it to 50%-55%, while German Chancellor Angela Merkel has stated she wants to build a consensus on this target revision during the German EU presidency. Increasing the target obviously implies that the investment gap is even larger than earlier estimates.

Compared to the proposal, we see two opposing developments in the final deal related to attracting private funds. On the one hand, the InvestEU programme gets less funding in the final deal (from €30.3 billion in the proposal to €5.6 billion in the final deal). As the InvestEU programme is designed to attract private money, this is not good news for the green agenda.

On the other hand, the final agreement states that the European Investment Bank (EIB) should have enough capital to implement EU policies. There will be a review of the capital adequacy of the EIB and on how the EIB can support the digitalisation and the fight against climate change. The review should be completed by the end of 2020. The higher capital would, in turn, allow for more risk taking and for more crowding in of private money.

Other tools

Apart from money that flows into green projects, taxes can also be used to further the green agenda. The final deal makes plans to introduce new taxes at the EU level more concrete and some of them will indeed push companies to pursue less carbon intensive production processes. The Commission will work on a revised proposal on the Emission Trading Scheme, possibly extending to aviation and maritime. The proposal on a carbon border adjustment mechanism should be made public in the first half of 2021.

Tax matters, however, need unanimous approval and so the actual implementation remains uncertain although some leaders, such as the French Finance Minister Bruno Le Maire, are openly supporting a shift towards qualified majority.

Conclusion

The Covid-19 crisis triggered a number of initiatives to kickstart and support the economic recovery. On top of this goal, we continue to see a willingness to support the green transition in Europe. Indeed, the European Council's deal targets a larger amount for green projects compared to the proposal of the European Commission and larger than the previous multiannual budgets. On top of that, Europe is also pursuing new taxes at the European level that would adjust the incentives of companies and consumers towards greener decisions.

In order to reach the European emissions reduction target, the proposed public expenditure is, however, not enough. There remains a lot of uncertainty around how much private investment can be attracted due to the EU initiatives. Developments surrounding the European Investment Bank will play a crucial role in this.

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