

# Potential unfulfilled

EU funding and Cohesion policy can do more for sustainable climate and energy development in central and eastern Europe



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## List of abbreviations

CEE – Central and Eastern Europe	ERDF – European Regional Development Fund
CF – Cohesion fund	ETS – Emissions Trading Scheme
DG – Directorate General	GHG – Greenhouse gases
EC – European Commission	GIS – Green investment scheme
EE – Energy efficiency	MA – Managing authorities
EEA – European Environmental Agency	MS – Member States
EEAP – Energy Efficiency Action Plan	OP – Operational Programme
ENEA – European network of environmental and managing authorities	RE – Renewable energy
EP – European Parliament	SME – Small- and medium-size enterprise

## Foreword

### “The EU needs to become a climate-friendly economy”.

This call has become increasingly familiar. Scientists too have been warning us for decades that our unsustainable lifestyles are provoking climate change. Economists and research institutes are insisting that the cost of inaction will be higher than the cost of the investments we need to make to turn our economy green. Millions of people around the world are already experiencing what climate change means. And, in the last few years, the climate issue has finally clambered up, almost out of breath, on to the top of the European policy agenda.

Yet, as this report on EU budget spending in central and eastern Europe shows, there is still a vast gap between hopes and intentions to achieve positive climate objectives and the actual use of available EU money to do so.

CEE Bankwatch Network and Friends of the Earth Europe's findings in this report describe how there is an ongoing failure in implementing the EU's current climate objectives, which are still low in comparison with what the EU could and should be doing in order to stop climate change. What is missing is the integration of EU climate objectives in our everyday life – in the way we do business, in the way we bring up our children, in the way we build or reconstruct our house, and in the transport modes that we decide to rely on and use. Yet the EU Structural and Cohesion funds (or, the EU funds) can be the catalysts for bridging the gap between policy and practice.

Totalling one third of the overall EU budget spending, the EU funds are a powerful financial instrument not primarily because of the scale of the funds but because of the leverage effect they have over other public and private investments; equally, they are important because they are earmarked for specific policy objectives. Indeed the EU funds have shown that they play an extremely crucial role in reshaping the economies of new member states. However, to date in central and eastern Europe, the deployment of the funds has not always been done in the most sustainable way – they have most often served a paradigm of development measured in cubic metres of concrete and kilometres of asphalt.

If, however, the EU funds are to bring cohesion and development in Europe and if the emerging EU project is to shift to a climate-friendly economy, then it is logical that the EU funds should feature in a new, mainstreamed arrangement: EU member states fully integrate EU climate objectives in their public spending and policies and receive financial help to manage the transition.

As this report outlines, in central and eastern Europe, there is some evidence to suggest that the economic crisis has been a greater factor in shifting our investments on to a more sustainable track than years of policy discussion in this area. A number of new member states, those that have been most severely hit by the crisis, have in fact increased their EU funds allocations for renewable energy and energy efficiency investments.

Again in response to the crisis, the EU's 2020 strategy foregrounds the need to mobilise EU resources to support green growth. European governments have been quick to mobilise resources to save the banking system, they now must do so to save citizens from the disastrous potential consequences of climate change – and they have the EU funds available and ready to do a lot of the hard work.

## Executive summary

The EU structural and cohesion funds have the potential to catalyse the transition to a low carbon economy in Central and Eastern Europe (CEE). Yet, as this latest analysis from CEE Bankwatch Network and Friends of the Earth Europe reveals, the prospect of this transition still remains remote for now. As we approach the midpoint of the 2007-2013 programming period, the pace of absorption of EU funds for renewable energy (RE) and energy efficiency (EE) projects remains slow even if the demand for financing is steadily on the rise.

This is disappointing – a green economy is not just an option but the only reasonable and long-term viable option for the CEE region as a way out of the economic crisis and towards a true twenty-first century economy. Investments in EE and RE are crucial for CEE countries as they can deliver multiple benefits – not only decreases in their emissions of greenhouse gases but also reductions in energy poverty, the creation of green jobs and the strengthening of local economies and innovation.

And the financial potential is massive. The Cohesion and Structural Funds will provide a total of EUR 347 billion for the 2007-2013 period, a figure which is more than one third of the total EU budget in this period. The CEE countries are indeed the main beneficiaries of the EU funds with EUR 177 billion, which is also the biggest source of public funding in the EU's newest member states.

The main role of EU Cohesion Policy has been to redistribute wealth between regions and to help poorer regions to catch up with the rest. In theory, according to Article 6 of the EC Treaty, cohesion and structural funding ought to integrate environmental concerns. In 2006, when the EU funds regulations were adopted, and 2007, when national spending programmes were approved by the EC, climate change was not recognised as a challenge for Europe's regions and did not feature as a priority. As a result, when the EU states declared their 2007-2013 spending allocations, climate mitigation measures received a meagre EUR 9 bn allocation for the EU27 as a whole, with EUR 4.2bn of this being allocated in the 10 new member states.

Yet since then climate change considerations in the EU regions themselves have come to more prominence with greater consideration now being given to the economic and social consequences of climate change in the regions.

The European Commission's Regions 2020 working document<sup>1</sup> clearly identifies the poorer Southern and Eastern regions that have limited adaptation capacity and that are set to be most affected by climate change. These negative impacts will affect not only their economic development but also the balance in their natural ecosystems and, ultimately, the quality of life of their citizens. In 2009, the Barca report went even further, claiming that the asymmetric effects of climate change are seriously "underscored" in the Regions 2020 document and that it is very likely that the cost of these impacts will be mostly borne by regions that are already disadvantaged, thus exacerbating further existing disparities<sup>2</sup>.

Indeed the world's scientific community is ringing the alarm bells ever louder and pointing to an increasing gap between what is needed to prevent a major climate breakdown and the slow pace of what is being done in reality. In recent years we have certainly seen an unprecedented rise in EU climate and energy policies. The '20/20/20' deal from 2008 was the first step in shaping a policy framework for the implementation of EU commitments to fight climate change. Yet designing a policy – a highly challenging one no less – without ensuring the necessary finances for its implementation is akin to setting out naked for a polar expedition.

The recent, ongoing economic crisis has also been taking its toll. Jobs have been lost and national economies have been put under severe strain. Investments in sustainable energy and climate mitigation will not only contribute to emissions reduction but can also reap numerous ancillary benefits ("double dividend") for social cohesion and economic development such as reducing energy bills for households and providing new employment and business opportunities. The Commission has estimated that the benefits from energy savings can amount to EUR 1000 per household annually<sup>3</sup> thus improving living conditions and alleviating "energy poverty".

Additional spill over effects include the creation of new jobs as well as the integration of jobless or low skilled persons into the workforce and hence strengthened social cohesion<sup>4</sup>. A modeling exercise supported by the EU found that under current climate policies there could be a net gain of 950,000 direct and indirect full-time equivalent jobs by 2010 and 1.4 million by 2020<sup>5</sup>. Moreover,

these measures can foster local knowledge and spur innovation in renewable and energy saving technologies while providing competitive advantages for local and regional economies.

Changes in EU funds allocations are too slow. One side-effect of the crisis has been that now mainstream economists and think tanks are questioning certain 'fundamentals' that had been taken as givens. For decades, the dominating paradigm in the EU has been the idea that economic prosperity and the public interest can only be achieved and best served by promoting competitiveness, deregulation, productivity and consumption, and that this in turn will lead to increased cohesion, reduced poverty and, almost automatically, advances in environmental protection without the need for much state intervention.

As these arguments are now increasingly seen as flawed, or at best simplistic, a further strengthening of EU climate and energy legislation based on, and supported by these reformulated economic and funding policies would be needed. In December 2009, the outgoing Commissioner for Regional Policy Paweł Samecki presented an orientation paper on the future development of the post-2013 EU cohesion policy. Although the focus of the policy remains largely the same with the emphasis on structural change and promoting growth, the paper also offers new insights on pursuing a transition to low-carbon and greener economies across the European region.

A 'smart-green' move out of the crisis emerged in the crisis management rhetoric heard in late 2008 and some steps were taken to speed up the shift towards a low carbon economy. The General EU funds Regulation 1083/2006 was modified in May 2009 in order to allow all member states to allocate up to 4 percent of their European Regional Development Fund allocations for renewable and efficient energy in housing. Again, encouraging signs, but far more should be done to match EU spending with real needs and policy targets.

The countries most hit by the economic crisis in the CEE region first realised the possible win-win effects from energy saving measures for economic recovery not to mention social benefits. The crisis has decreased disposable incomes and taking bank loans is not an easy option anymore, making the EU funds even more important for financing such measures. This is resulting in an even greater demand to increase EU funds allocations for such projects now in the mid-term of the current financial period.

The member states, however, should ensure that absorption barriers are overcome in order to accelerate the implementation of EU funds for energy efficiency and renewable energy. These opportunities must be used immediately so that the absorption capacity is increased, which could stimulate more significant use of the EU funds for renewable energy and energy efficiency in the future budgetary period.

Member states should also use the opportunity to increase their allocations of EU funds for energy efficiency and renewable energy already within the current programming period. Mid-term evaluations and shifts in allocations should reflect the rapidly increasing priority given by the EU to climate change mitigation and adaptation and the high interest of applicants in such projects. The Commission should more actively encourage immediate shifts and member states should ensure that projects in the field of energy efficiency and renewable energy are selected according to adequate quality criteria.

Finally, more ambitious reform is needed of the post 2013 Cohesion policy and EU Financial Framework.

# 1. Methodology

This report assesses the spending of EU funds for energy savings and renewable energy in selected new Member States in the mid-term of the 2007-2013 programming period. It also explores the national fiscal responses to the economic crisis and looks into how CEE countries utilised EU funds for climate related measures.

The methodology for this report included rigorous desk research based on primary and secondary data. Field research was carried out in selected new Member States where the information was collected by CEE Bankwatch Network and Friends of the Earth Europe national groups. Data was collected and analysed in Latvia, Lithuania, Estonia, Poland, Hungary, Czech Republic, Slovakia and Bulgaria between August and September 2009. The collected data provides an overview of the state of play in EU funds spending by September 2009 for EE and RE measures in these countries. A quantitative analysis was conducted to assess the absorption rate of EU funds spending for EE and RE measures whereas a qualitative analysis was carried out to explore the success factors and barriers for EU funds absorption.

The data availability and access to information varied considerably across the countries. Therefore, information about projects is often scattered and more in-depth research is needed to collect detailed information on a project basis which however was not possible within the scope of this research. Therefore, this report is limited to looking into total spending and presents findings regarding absorption capacity for EE and RE measures but does not look into specific projects.

Data about the actual spending of EU funds is usually accessible on the internet in most countries. However, due to different reporting standards it is difficult to compare it across countries. Some countries publish data regarding EU funds contribution to the total cost of approved projects (Slovakia, Latvia) while others publish EU funds contribution to the total cost of projects contracted (Czech Republic, Hungary, Lithuania, Poland). Few countries publish data about actual funds being disbursed to beneficiaries to date (Czech Republic). In one country data was published only about EU funds contribution to the total cost of public building renovation projects which envisaged *inter alia* the implementation of EE and RE measures. However, it was not possible to discern what part of the total renovation projects' costs constituted EE and RE measures (Bulgaria).

This methodological challenge was made more difficult in some cases by bureaucratic unwillingness to disclose information. In Slovakia, the Ministries of Construction and Regional Development and the Ministry of Economy obstructed access to information on EU funded projects<sup>6</sup>. This means that citizens' organisations, like Friends of the Earth Slovakia, have to rely on sporadic information and the judgement of experts and campaigners on the ground.

## 2. A changing environment for cohesion policy

### 2.1 Economic crises and the EU response

#### Short-sighted recovery initiatives

The economic crisis that hit Europe in 2008 led to a sharp increase of state interventions. This would have been an opportunity to switch to a green and climate friendly economy<sup>7</sup>. As a first reaction to the crisis most EU Member States poured money into demand-stimulating programmes and into guarantees to keep financial institutions afloat.

However, despite some rhetoric to the contrary, these programmes were largely designed without serious attempt to stimulate green and climate friendly development. Only 11 percent of the funding from national stimulus packages in the EU claim to be "green"<sup>8</sup>. This includes for example the German car scrappage scheme which does not provide clear environmental incentives. The most promising measures in the packages are support measures for energy efficient renovation of buildings, which account for some 40 percent of the green measures presented.

The European Commission (Commission) included in its economic recovery plan<sup>9</sup> *inter alia* the strategic aim to "speed up the shift towards a low carbon economy" and called for funding to improve the energy performance of buildings. Over half of the EU finances mentioned in this plan (EUR 18 billion out of a total of around EUR 30 billion) are presented as green measures<sup>10</sup>. But in reality 80 percent of this "green money" is to be spent on large scale and the yet unproven technology carbon capture and storage (CCS), and gas and electricity interconnectors – which do not have direct environmental benefits.

## The case for a new long-term perspective

But the opportunity is not gone. The economic recovery plans adopted so far have mostly consisted in short-term measures targeting the financial system and the most threatened economic activities. European leaders are under continuing pressure to develop new economic and financial policies due to the increasing debt burden and the continuing ecological and climate crisis.

This requires a fundamental review of the EU strategy for growth and competitiveness in order to facilitate a transition toward eco-innovation, green jobs and a low-carbon and resource-constraint economy. The EU's Lisbon strategy from 2000, which made competitiveness and economic growth the top priorities, emphasised de-regulation and had largely a negative impact on environmental policy development. The strategy was re-reinforced in 2005.

In November 2009, President Barroso proposed a new vision for economic and social development in the European Union, which was embraced in

the successor of the Lisbon Strategy, the EU 2020 Strategy. The draft Strategy, which was subject to public consultation until January 15, 2010, proposes that one of the key objectives of the EU should be to find new sources of growth in order to create a “competitive, connected and greener economy” by promoting eco-innovation and energy efficient products and processes. The Strategy is scheduled to be adopted by the Spring Council in 2010 <sup>11</sup>.

## Why a green transition is crucial for a long-term recovery

Investments in sustainable energy and climate mitigation will not only contribute to emissions reduction but can also reap numerous ancillary benefits (“double dividend”) for social cohesion and economic development such as reducing energy bills for households and providing new employment and business opportunities. Moreover, they can spur innovation in renewable and energy saving technologies and provide competitive advantages. Investing in energy efficiency is the cheapest and most effective way to address current energy challenges at national, regional and local levels while increasing energy security.

**Table 1:** The EU Climate Package – GHG and renewables mandatory targets

	Non-ETS GHG emissions limit in 2020	2005 share of RE (%)	2020 RE target (%)	RE share increase
Bulgaria	+20%	9.4	16	+70%
Czech Republic	+9%	6.4	13	+103%
Estonia	+11%	18	25	+39%
Latvia	+17%	32.6	40	+22%
Lithuania	+15%	15	23	+53%
Hungary	+10%	4.3	13	+202%
Poland	+14%	7.2	15	+108%
Romania	+19%	17.8	24	+35%
Slovenia	+4%	16	25	+56%
Slovakia	+13%	6.7	14	+109%
Average per country (CEE)	+13.2%	13.34	20.8	+56%
Average per country EU15	-14%	11.73	23.13	+97%
Average per country EU27	-2.89%	11.56	21.41	+85%

The Commission has also estimated that the benefits from energy savings can amount to EUR 1000 per household annually<sup>12</sup> thus improving living conditions and alleviating “energy poverty”. Reducing CO2 emissions in the EU by 10 percent by 2020 would generate enormous health benefits estimated at EUR 8 to 27 billion.<sup>13</sup>

Additional ancillary effects include the creation of new jobs as well as the integration of jobless or low skilled persons into the workforce and hence strengthening social cohesion. A modelling exercise supported by the EU found that under current policies, there could be a net gain of 950 000 direct and indirect full-time equivalent jobs by 2010<sup>14</sup> and 1.4 million by 2020. According to figures from the European Renewable Energy Council (EREC), gross employment in the EU is to rise by another 2 million in the RE sector by 2020. The Commission’s own estimates suggest that energy end-use efficiency investments can create three to four times the number of jobs created by comparable energy supply investments e.g.. coal-fired and nuclear power plants<sup>15</sup>.

## 2.2 Climate at the top of the EU policy agenda

Climate policies have come a long way to emerge now at the top of the EU policy agenda. This has great implications for Europe’s internal market, energy, transport, environment and funding policies. Europe’s highest level strategies - Gothenburg<sup>16</sup>, Lisbon<sup>17</sup> (as well as the future EU 2020 Strategy) - are increasingly influenced by this climate focus. But being at a high level also means high level exposure and pressure from particular interest groups. The new climate and energy laws have therefore been seriously compromised to accommodate diverging interests and to comfort the inertia of many actors.

### The EU Climate and Energy Package

In March 2007, the European Union unilaterally committed to reducing its CO2 emissions by 20 percent by 2020 compared to 1990, and by 30 percent if other developed countries adopt comparable targets. A target of 20 percent renewables in the energy consumption was also adopted.

This commitment was made operational through the final adoption in 2009 of a Climate and Energy legislative package by the European Parliament

and Council including **national mandatory targets** to be reached by 2020 (see Table 1) for GHG emissions from sources not covered by the EU ETS and for the share of energy from renewable sources.

In addition, the single EU wide GHG emissions cap and EU harmonised allocation rules for allowances should help **generate substantial revenues**<sup>18</sup>, of which at least 50 percent are to be used for a range of mitigation and adaptation activities, including energy efficiency and developing renewables.

Finally, the Climate Package confirmed the EU’s commitments to lead GHG emissions reduction with a view of achieving a 60-80 percent reduction by 2050.

### National targets: low ambition for central and eastern Europe

This new legislative framework was met with reluctance by the new Member States which led to a number of loopholes and weaknesses in the final laws.

Specifically GHG emissions and renewable energy targets for the CEE countries are far less ambitious than for the other Member States (see Table 1).

For the non-ETS sectors, all CEE countries are actually allowed to increase their emissions, from 4 percent to 20 percent over their 2005 levels.

Increasing GHG emissions in CEE countries goes against the idea of a shared global responsibility. It is also a wasted opportunity to play a frontrunner’s role: the effort of sharing targets for CEE countries cement an outdated development path and suggest that those countries will follow the unsustainable development path of “old” Member States instead of adopting new economic policies based on low energy and resource input, renewables and green jobs.

Similarly, **the adopted RE targets for CEE Member States lack ambition**, especially compared to the targets set for EU 15. On average a CEE Member State has to increase the RE share by 56 percent, whereas on average an EU 15 Member State has to double the share.

Renewable energy is relatively underdeveloped in many CEE Member States. Important investments are needed to make solar and wind power viable, but governments are still reluctant. The role of the

EU is therefore crucial to foster the development of RE and help it reach a critical mass.

The adoption of mandatory RE targets represents clear progress for the CEE countries. However, the weakness of the objectives will leave them falling behind the rest of Europe. This could prove counter-productive and threaten cohesion objectives. In some cases the targets also risk being too weak to foster a sustainable energy supply infrastructure. In Hungary for example, the RE target is likely to be reached only through the large-scale firing of biomass in power plants<sup>19</sup>, which, depending on the type of fuel used and the efficiency of the plant, may have negative overall environmental effects.

### Mandatory targets for renewable energy

Annex I of the Renewables Directive<sup>20</sup> sets out for each Member State a mandatory national overall target for sharing energy from renewable sources in 2020. The choice of measures to reach this target is left to the Member States who will have to set out the respective RE targets for the transport, electricity and heating and cooling sectors in national RE action plans.

Another issue under the ETS revision is that new Member States managed to get **significant exceptions** on what they can do with revenues from ETS allocations – many are on the way to using the exception and to give the revenues back to polluting power utilities, instead of using them for more environmental and climate friendly purposes, such as financing energy savings or meeting financing obligations in developing countries.

## 2.3 Energy savings: a huge potential in CEE countries

Reducing energy use is the cheapest and easiest way to reduce GHG emissions and a prerequisite in preventing dangerous climate change. Although the energy intensity of the new Member States has been decreasing steadily in the last 15 years, it is still significantly higher than in the EU15.

The **housing sector has a crucial role to play**, as it is responsible for 40 percent of all GHG emissions in CEE countries. The potential for energy-efficient refurbishment is immense: most of the old high-rise buildings stock requires a renovation anyway. In Hungary, for example, it is

**Table 2: Primary energy intensity in 2006** <sup>21</sup>

Energy intensity (toe/M€ GDP)	
EU27	177
Latvia	435
Poland	428
Czech Republic	586
Bulgaria	1090

estimated that 24 percent of all buildings need a comprehensive refurbishment, whereas 40 percent need to be partially refurbished.

But even without taking into account the climate dimension, the **“spill-over” benefits** of investments in energy conservation measures justify making them the top priority for CEE countries. They will lead to:

- Reduction of the need for energy imports and dependency on Russia;
- Competitiveness gains linked to increased local investments;
- New jobs, in the housing sector in particular: the potential is estimated at up to 185,000 in the CEE-10; and
- Local knowledge and innovation.

According to Hnuti Duha’s estimates, energy conservation measures could allow for a 60 percent reduction of all the energy used in buildings in the Czech Republic<sup>22</sup>. In Hungary, the overall energy efficiency improvement potential is estimated at 30 percent.

The realisation of these potentials will require **political ambition** at the national and, even more so, at the EU level. Under its current term, the Commission has stepped up its efforts to promote energy efficiency in the heating and cooling, industrial, transport and domestic sectors.

### Need for EU targets

However, so far the **EU’s overall regulatory framework on energy efficiency is weak as it does not set a binding energy savings target**. In 2006, the Member States committed themselves to achieving primary energy savings of 20 percent by 2020 compared to business as usual scenarios and adopted together with the Parliament an indicative 9 percent final energy saving target by 2016 via the Energy Services Directive.

But the EU is set to fail in achieving its commitment unless drastic policy changes are made. According to the latest Commission assessment<sup>23</sup> current policies together with the ones in the pipeline will only achieve 11 percent energy savings by 2020. This will roughly correspond to stabilising energy use in the EU, compared to 2005, and a 6 percent increase from 1990, the Kyoto baseline year.

In the domestic sector, directives on the energy efficiency of buildings and on energy labelling are currently under revision and their scope will be expanded. Implementation measures of the Directive on energy-using products are also being developed<sup>24</sup>. In particular, energy efficiency requirements for boilers, water heaters and air-conditioners could substantially contribute to energy saving in Europe in combination with reinforced and improved national renovation programmes. A Communication and detailed guidelines on co-generation were also issued in 2008 in order to improve energy efficiency of electricity generation, following a Directive on this issue approved in 2004.

New financial instruments for energy efficiency are also being considered, such as an EU Sustainable Energy Financing Initiative. In order to speed up this process, the European Parliament asked the Commission last year to revise the EU Energy Efficiency Action Plan (EEAP).

In order to set the pace for all Member States and trigger the potentials, it is essential that this new EEAP sets national mandatory energy savings targets. In the absence of such targets, the EU legislation on energy savings will remain largely ineffective and will not have the means to drive change at national level.

## 2.4. Climate change adaptation: an emerging policy

EU policies and debates to address adaptation to climate change have started emerging only very recently. In 2007 the Commission presented a Green Paper and in April 2009 a White Paper on adaptation to climate change. These non-legislative proposals seek to establish an EU Adaptation Framework with the objective to “improve the EU’s resilience to deal with the impact of climate change”, based on four pillars:

- 1) Developing knowledge base;
- 2) Integration into existing EU policies;

- 3) Mix of policy instruments; and
- 4) International cooperation.

Importantly, the White Paper highlights the importance of mainstreaming adaptation in EU funding policies. With regards to EU cohesion policy, the paper makes some extremely useful suggestions:

- Develop methodologies for climate-proofing infrastructure projects and to consider how these could be incorporated into the TEN-T and TEN-E guidelines and guidance on investments under cohesion policy in the current period;
- Explore the possibility of making *Climate Impact Assessments* a condition for public and private investment;
- Assess the feasibility of incorporating climate impacts into construction standards, such as Eurocodes; and
- Develop guidelines by 2011 to ensure that climate impacts are taken into account in the EIA and SEA Directives.

The key issue is how to finance adaptation. In CEE countries in particular, where the economic and social structures remain vulnerable, adapting to climate change will require huge investments. EU Cohesion policies should be adapted to take this into account.

## 3. Redefining cohesion: from undermining to supporting EU climate and energy objectives

It is important that EU money supports the implementation of EU climate policies and that this is a question of improving national, regional and local decision-making, revising EU high level strategies and better integration of policies.

If this does not happen, the risk is that climate targets will be a function of predetermined public spending rather than the other way around. This is an issue not just for CEE countries, but for the EU overall. A recent report by the European Environment Agency (EEA) also highlighted a huge difference in the way countries such as Austria, Italy and Spain use structural and cohesion funds to pursue – or not – environmental objectives<sup>25</sup>.

The strategic guidelines of the EU Cohesion policy for 2007-2013 were designed in 2004 to cope

with the integration of 12 new countries with a significantly lower economic level, under the principles of the Lisbon Strategy – concentrate resources on growth, competitiveness and employment.

Although climate change has been placed on top of the EU agenda, sustainable low-carbon investments have yet to be granted a place of their own in the EU funds.

#### **Existing funding opportunities for energy efficiency and renewable energy sources**

In 2009, the EU increased the eligible maximum level of ERDF support to expenditures for EE and RE in housing to 4 percent of the total ERDF envelope in each Member State. This represents a limited progress for CEE countries (previously 2 percent), whereas their need for improvement is the greatest (decaying building stock).

While housing measures are thus limited under the cohesion fund, measures targeting non-housing buildings, like public or office buildings, are eligible without a specific limit.

The EU Energy Efficiency Action Plan mentions, among the measures the Commission will take to finance energy efficiency, *“facilitate leveraging or financing for energy efficiency projects, including the multifamily and social housing sectors, in the new Member States through the structural and cohesion funds (2007-2012)”*.

The other possibilities for funding are mostly related to the improvement of energy and transport network infrastructure, which in the EU’s view should contribute to improving the efficiency of the energy production and transport system.

Although in old Member States, state aid allocated to EE and RE has increased considerably, this is not really the case in CEE countries where EU funds still represent the major share of support to EE and RE investments.

Some of the structural funds can be used for “community initiatives” led on local level. Three of these are programmed for 2007-2013. Among them, JESSICA (Joint European Support for Sustainable Investment in City Areas) is aimed at helping to finance urban development projects.

### **3.1 Cohesion money needs to reach ambitious climate and energy targets**

Cohesion money could make it easier for new Member States in particular to reach their emissions reduction and RE targets and to reduce energy use. Targeted EU investments can, for example, trigger the take-off of renewable energy production and energy efficient building renovations. This could be crucial at a time when available money is fiercely fought for as national budgets are still struggling to recover from the financial and economic crises.

At a more political level, EU money is part of an implicit trade-off between the EU and its poorer Member States. EU structural and cohesion funds were initially introduced to compensate for the negative impacts of the internal market and single currency policies and to ensure the continued political support from less well-off countries by making it easier for them to adapt to the added constraints and costs resulting from EU laws.

If the emerging new EU project is to fight climate change then it is logical that EU money has to be used in a new trade off: countries accept tough climate and energy targets and get financial help to manage the transition.

#### **The need for urgent, significant mitigation in CEE countries**

Although the energy intensity of the new member states has been decreasing steadily in the last 15 years, it is still significantly higher than in the EU15 (for example, Bulgaria has energy intensity approximately five times higher than the overall EU average)<sup>26</sup>. The housing sector has a crucial role to play, as it generally shows poor energetic performance compared to western European countries and is responsible for 40% of all GHG emissions in the CEE countries. The potential for energy efficient refurbishment is immense: most of the region’s old high-rise buildings stock requires renovation anyway.

Energy savings and renewable energy programmes need upfront capital to unlock private investments and render these measures commercially viable. Additional benefits will be reaped if these programmes are increasingly mainstreamed across other cohesion policy interventions via explicit requirements in project application forms, project selection criteria and green public procurement.

The realisation of these potentials will require stronger political will both at national and EU levels but also targeted financial support to accommodate the needs. With shrinking public budgets and limited access to bank loans during the economic crisis, CEE countries must turn to the EU funds to unlock the potentials, leverage private capital and facilitate the transition towards a low carbon future.

### 3.2 Cohesion policy: long-term support for EU policy orientation

The cohesion and structural funds will provide a total of EUR 347 billion for 2007-2013, which is more than one third of the total EU budget for the period. The main role of EU cohesion policy has been to redistribute wealth between regions and to help poorer regions to catch up with the rest. The main indicator and measure for the Cohesion policy is GDP. Following this logic, around 50 percent of the total funds will be allocated to the 10 CEE countries.

Besides this basic objective, the funds have developed a “life of their own” and specific objectives have been developed and reviewed with each financial period.

The difference of timescale between these programming periods and the EU environmental policies explains the gaps that have appeared between policy priorities and funding guidelines. In particular, the 2000 ‘Lisbon Strategy’, which introduced economic growth and competitiveness as the top EU priorities, made life harder for those arguing that funding should be in line with Europe’s environmental objectives, as these were seen as lower level objectives. And although the future EU 2020 strategy might reduce the conflict of priorities at the policy-making level, the 2007 Cohesion guidelines, which were adopted when the Lisbon strategy priorities were leading all the action of the EU, will persist until 2013 and the share of RE, GHG emissions and reduction of primary energy will wait to become as important as GDP or jobs creation in defining progress.

The guiding role of cohesion and structural funds is crucial in the new EU Member States, where they can bridge the huge gap between the investment needs in infrastructure, buildings, renewable energy production and the available money. With that powerful financial leverage, the EU directly interferes with and provides guidance for the

development path of CEE countries, which may have huge consequences in the future. A 2007 Bankwatch report highlighted a risk for a repeated “Spanish scenario”<sup>27</sup> in CEE countries.

The European Commission carries big responsibilities in the process of determining the Funds’ priorities: all the Operational Programmes (OPs) must be approved by the Commission, which can decide to reject them if they don’t provide sufficient guarantees or don’t fit in line with the cohesion policy.

In countries where local and national authorities are not concerned enough about environmental and climate issues, the role of EU support is central to complement and often lead national action. As they are set on long-term objectives, EU funds can boost investments in those sectors where governments are not able or not willing to take action. Not enough public funding goes to green projects: a lack of political leadership and the competing needs of other economic sectors tend to keep national money flowing to traditional economic sectors and governments are unwilling to act on climate issues unless specifically required to by the EU.

This lack of responsibility was particularly highlighted in an answer from the Slovak Ministry of Environment, indicating that *“unless expressly stipulated by the European Commission to pay more attention to climate change effects of every individual project, applicants cannot be expected to show increased interest in the issue of adaptation and long-term mitigation of measures”*<sup>28</sup>.

## 4. The paradox of the slow absorption: demand for EU funds is on the rise and yet little has been spent

Demand for financing for EE and RE measures is on the rise in CEE countries. Among some of the reasons for this demand are possible economic and social benefits from such investments, the search for new sources of growth in the crisis context and the weight put on the new EU climate policy. EU funds are only one of the fiscal instruments to provide such investments but

are one of the few such instruments in the new Member States whereby its importance is further amplified by restrained national budgets.

The need for funding for collective housing refurbishment in particular is very high, and it can be seen that after a slow start, such Operational Programmes are quickly taking off and are very successful. In the Czech Republic, despite a late start, the OP Environment is being implemented quickly, and it is expected that all the available allocation for energy savings in this OP should have been approved by the end of 2009.

The same situation exists in the case of public buildings. In Poland, financing all good-quality projects (approved and reserve list projects) submitted in the first round of applications for energy efficient refurbishment of public utility buildings would require about four times higher allocation. Provided the evidence of high demand, Poland is only now starting to consider possible actions to shift EU funding towards renewables or energy savings.

## 4.1 Reactions to the economic crisis: an increased interest for energy savings

The beginning of the implementation of the 2007-2013 EU funds coincided with the economic crisis. As described earlier, this situation presented an opportunity for investing in long-term development, in particular by redirecting some of the EU money into sustainable energy investments. Some CEE Member States did react to the economic crisis by redefining their funding priorities and reorganising the OPs. In addition, the Russian-Ukraine gas crisis of January 2009 struck CEE countries and stressed further the need for enhanced energy security of supply.

The countries most hit by the economic crisis in the CEE region first realised the possible win-win effects of energy saving measures for economic recovery and social benefits. They have placed EE/RE projects at the core of national stimulus packages, in which EU funds appear as a central fiscal instrument. The demand for EU funding is therefore increased as a preferred option for member states whose budgets are hit hard by the crisis.

In *Latvia*, EU funding for improving heat insulation in multi-apartment residential buildings will

triple to EUR 63 million and will not require additional public co-financing. The government has also increased support for the development of cogeneration power plants utilising renewable energy sources by EUR 10 million, making the available funding for this measure approximately EURO 35 million.

In *Lithuania*, the government has placed energy savings at the core of its economic stimulation plan, and will seek to speed up the pace of implementation by absorbing EUR 1.45 billion of the EU funds instead of the planned EUR 960 million by the end of 2009. A large share of this money should go to energy savings.

In *Bulgaria*, energy efficiency and renewables were given higher priority following the gas crisis in January, and it was decided in particular to use the JESSICA mechanism to support sustainable investments in urban areas. In addition, EUR 91 million from the OP Regional Development were reallocated to energy efficiency and renewables measures in public schools, universities and social institutions owned by municipalities in urban areas.

The *Estonian* government commissioned a study by Ernst and Young on suggested changes in its OPs. The proposed measures target, in particular, EE.

The interest towards EE and RE projects as 'smart green' anti-crisis measures is accompanied by the growing interest among possible private or public beneficiaries of EU funds. In some countries, in spite of the slow start in EU funds absorption for EE/RE projects especially in public buildings, the interest of applicants in such measures is significantly exceeding the available funding.

In the *Czech Republic*, despite a late start, the OP Environment is now being rapidly implemented. It is expected that all the available allocations for energy savings in this OP will be exhausted by 2010. In *Slovakia*, according to the Ministry of Environment, the number of applications exceeds the available amount of financial means for the operational goal "Protection of the environment and mitigation of climate changes". For a call aimed at making public lighting more efficient, the number of project applications far outreached the expected amount (400 applications compared to the expected 200). EU funding for RES/EE in Slovakia is very important as the state's support for such measures is very low.

In Poland, the requested EU funding in the first round under the measure “Energy efficient refurbishment of public buildings” exceeded the available allocation more than ten times.

## 4.2 Yet, little has been spent

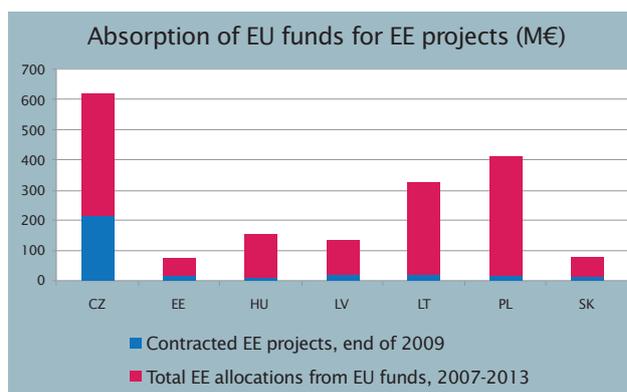
While interest and demand in EU funding for EE and RE measures is on the rise, the research findings show one major trend across all countries subject to this study - EU funds available for EE and RE projects are being contracted and spent very slowly. Nearly three years into the 2007-2013 programming period, the number of contracted projects is still low and very little actual spending has been done.

The following graphs compare the contracted EU financed projects aimed at reducing energy use and increasing the use of renewable energy against the total available EU funds for the 2007-2013 programming period for such measures. Hence, the graphs demonstrate the low rate of absorption at a country level. They also compare the use of EU funds for such measures across selected CEE countries and show the similarity in the trend for slow absorption.

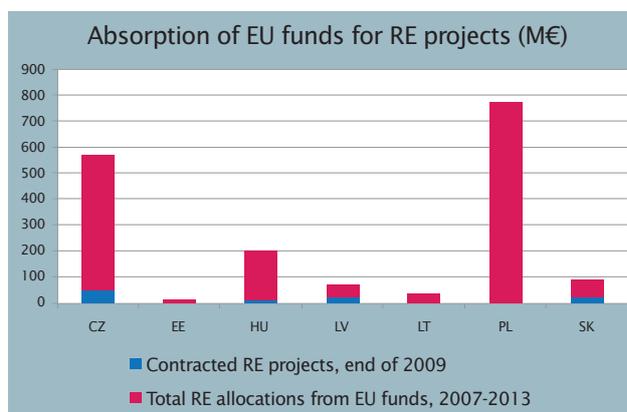
“Total allocations” is the total EU funds that were made available respectively for EE and RE in the Operational Programmes in each country for the entire 2007-2013 programming period. The figures are taken from the official statistics published by DG Regional policy. In some countries, these allocations have changed as sums of money have been reallocated or switched between OPs as a response to the economic crisis. The graphs take into account the latest available figures (Latvia).

“Contracted projects” corresponds to the total EU funding for EE or RE projects which were contracted by September 2009. The figures are based on the field research conducted by Bankwatch and Friends of the Earth Europe national groups in the selected new Member States. It should be noted that due to lack of available data in Slovakia, the figures under “contracted projects” show the EU funds support for all ‘approved’ EE and RE projects in the open competitions, which is higher than the actual contracted projects. In Latvia, the available data for RE projects was also limited to the EU funds contribution for ‘approved’ projects so this value was used in the analysis. Therefore, by September 2009, the actual spending in these two countries should be considered even lower.

**Table 3: Absorption of EU funds for EE projects**



**Table 4: Absorption of EU funds for RE projects**



It must be also noted that although research was conducted in Bulgaria, data is not included in the quantitative analysis because there was no clearly discernible available data on the spending of EU funds specifically for EE and RE measures. Therefore, the data presents findings on the absorption rate of EU funds in Czech Republic, Hungary, Estonia, Latvia, Lithuania, Poland and Slovakia.

The total EU funds allocations for EE measures between 2007 and 2013 in all seven countries where the field research took place amounts to EUR1,796 million, whereas the total amount of EU funds for contracts signed is only EUR 292.43 million. This amounts to roughly 16.3 percent absorbed funding. Only in the Czech Republic, despite the slow start with the implementation of the OPs supporting such measures, has spending been quickly advancing. The rest of the countries have experienced very slow absorption compared to their total allocations.

In the field of RE the situation is even more striking. From the total RE allocations, which account for EUR 1,751m, merely EUR 99.72m EU funding was contracted. This shows that only

5.7 percent of the EU funds for RE measures had been absorbed by September 2009. In Poland, which is the biggest recipient of EU funding for RE measures, only a couple of small scale projects have been contracted in the countryside whereas most investments have not been contracted so far. The Czech Republic does not perform as well compared to the absorption of EE projects showed in the previous graph.

The analysis, therefore, so far shows two major trends regarding the use of EU funds in renewable energy and energy saving projects in selected CEE countries. It showed that the demand for funding from the EU is on the rise for such measures. However, at the same time, these same countries struggle to absorb the available funding.

Therefore, this report further explores common barriers and obstacles for absorbing EU funds for EE and RE measures in these countries. It also looks into what possible actions and good practices could help countries overcome the obstacles and accelerate the implementation of these urgently needed projects.

### 4.3 Factors explaining the slow absorption

Significant delays in the absorption of EU funds for EE and RE measures can be observed across all CEE countries explored in this study. The main obstacles include **limited capacity of the managing authorities, a complicated application process and criteria and a lack of co-financing and upfront investment**. The study delves into details in these factors and gives country examples to illustrate the implementation deficit of EU funded projects in the field of energy efficiency and renewable energy.

Significant delays in the process, such as the **late opening of the calls, difficulties with procurement procedures, the need to get a green light from the Commission on State aid**, etc., are the most frequently cited obstacles to the efficient use of EU money across all new member states. These delays are generally linked to the low capacity of the EU funds managing authorities but also, more specifically, to the fact that climate mitigation projects are not seen as a priority by many governments.

In some cases, no projects at all have been contracted so far. The *Czech* “Integrated OP”,

managed by the Ministry for Local Development, offers funding for residential reconstruction and modernisation projects under the measure “Improving conditions in vulnerable and residential areas”, which benefited from EUR 192.57 million from the ERDF. However, the first call was only published at the end of May 2009 and no project had been approved as of August 2009.

Not a single RE project has been approved in *Estonia* so far. In *Bulgaria*, measures for EE/RE in SMEs under OP Competitiveness have not started yet because the Bulgarian authorities have still to resolve a question about the administration of such projects with the Commission – first calls will be launched only in 2010.

In *Lithuania*, for similar reasons, the “Multi-apartment House Modernization Program” is to start only in 2010. Disbursement of the money didn’t start until October 1, 2009 in *Slovakia*, where delays were caused mainly by general delays in the implementation of OP Environment, and further delays can be expected due to difficulties in carrying out public procurement procedures.

Another barrier is the very **limited knowledge of the issue of climate change** mitigation among potential applicants. In the public sector, mayors, schools and hospital directors (those who usually apply for projects) tend to only invest in refurbishment without considering possible long-term energy cuts. Positive examples of projects are mostly submitted by municipalities where the officer in charge is personally interested in the issue<sup>29</sup>.

The inability, ineffectiveness and improper preparation of managing authorities are widespread problems in CEE countries. This is further exacerbated by the high administrative burden for applicants. **The complexity of the application procedure** is another powerful disincentive – applicants often lack experience to deal with the application criteria, required data, technical and legal documents, assessment of expected impacts of the project, reporting and monitoring requirements, etc. These requirements represent a considerable administrative burden for small projects carried out by individuals, associations or SMEs. Local administrations and agencies often lack capacity to support applicants in presenting solid projects.

This problem is not specific to climate projects, as the complexity is linked with the general

administrative setup of the EU funds. In *Slovakia*, the responsible authorities justify their administrative procedures by the need for transparency. However, it is difficult to assess which level of detail is necessary to ensure transparency of the selection process. Such a complex procedure allows the managing authorities to shift the responsibility to the applicants, and thus to avoid unexpected problems that might occur at any stage of the project cycle. The long bureaucratic process that applications have to go through is therefore one of the main reasons of the delayed implementation.

Another factor lies in the **negative perception of the procedure**. In *Latvia* and *Bulgaria*, in order for applicants to be eligible for EU funding for multi-apartments residential measures, they are required to cooperate and apply as associations. This was considered to be one of the main barriers.

Another explanation is that **upfront investment needs** are too high for individuals or SMEs, even when the EU co-financing rate is high. Administrative costs, the need to resort to more expensive authorised or certified companies and, the fact that the payment is usually made after the project is completed, make this upfront investment very difficult to manage, compared to what a simple refurbishment would cost. With the economic crisis, it seems that people are even more reluctant to rely on long-term savings calculations, but are also less likely to, for example, take a loan.

Banks have a role to play too. In *Lithuania*, commercial banks consider it too risky to participate in the new housing renovation programme, although the government guarantees 80 percent of the amount. This problem applies mostly to residential housing: public institutions, which have state guarantees and don't need the involvement of private banks, tend to move forward much more successfully. However, the economic crisis has increased the budgetary stress on public institutions.

The example of *Slovenia* strikes as a huge missed opportunity to use EU funding: the activities of the Slovenian National Energy Efficiency Action Plan should have been 85 percent co-funded by the European Cohesion Fund. However, in the last two years the former and current governments failed to secure the required 15 percent national co-financing, thus missing the opportunity to use EUR 79 million of EU money for this period.

## 4.4 How to tackle the slow absorption and enhance the uptake of EU funding for EE and RE measures

The previous chapter showed that despite the fact that the demand for EU funding for EE and RE measures is steadily growing, CEE countries are dramatically failing to absorb even the available funding. The current 2007-2013 programming period still provides an opportunity to tackle the absorption problems at the midterm so as to ensure that climate mitigation actions are not postponed until after 2013 when the new programming period is to commence. Furthermore, proactive actions to address the slow uptake of EU funding now could also help CEE countries be better prepared for the programming and implementation of the post-2013 period.

Therefore, this chapter offers possible actions which can ease the implementation of EE and RE projects supported by EU funds. It also gives examples of actions undertaken in some countries which could be applied to other countries too.

### 1) Improve administrative capacity for selection, management and monitoring EU funds that support EE and RE projects

In order to make the project cycle faster and more efficient, ensure quality control, co-financing and long term sustainability, the management of EU funds – in particular small residential EE projects – could be effectively left to dedicated **state agencies**.

A state agency dealing exclusively with all EE projects in the residential housing sector could make the projects' management more efficient and faster, ensure quality control, co-financing and long-term sustainable continuity for the renovation of residential housing. This single agency should have clear criteria, control mechanisms, simplified and uniformed procedures that would reduce the administrative burden on applicants and would still ensure efficient and coordinated financing while achieving the main objectives of the projects, notably good quality energy efficiency and CO2 reduction.

Furthermore, mechanisms to **provide assistance to EU funds administrators or applicants** are proving decisive in increasing the absorption capacity. In the *Czech Republic*, where the

absorption of EU funds for EE projects is the highest, the State Environmental Fund organises trainings for project administrators and launched a programme called Energy Management for Municipalities, in partnership with private companies and energy consultancies.

Knowledge and skills development in the selection, management and monitoring of EE and RE projects supported by EU funds is fundamental especially at regional and local levels of administration but also at central levels where the managing authorities operate. In some Western countries, the responsible administrations have hired specialised experts dealing with climate proofing EU funded projects. They will have exclusive duties to steer targeted funding for EE and RE projects but also will act as catalysts for change by ensuring the mainstreaming of EE and RE measures in other EU funded programmes/projects. For example, one step towards this **mainstreaming** can be made through strengthening the application of green public procurement in all EU funds projects and achieve indirect efficiency and emissions reduction results.

The Commission can also play a role in facilitating better cooperation and exchange of good practices among countries in the field of EE and RE projects. Countries like Spain and Italy have developed national networks of environmental authorities managing EU funded projects which are designed to generate and exchange good practice and spur mutual learning and innovation. Similar exchanges can be amplified at the EU level via the already existing ENEA (European Network of Environmental and Managing Authorities) coordinated by DG Environment.

Furthermore, the long awaited Communication from DG Regional policy on how EU funds can better deliver sustainable development projects should be used in a pro-active way by the geographical desk officers at the DG to assist member states into making the best possible use of EU funds for climate mitigation projects already in the current 2007-2013 programming period.

## 2) Find a good balance between a reduced administrative burden and good criteria

The administrative burden and complex application procedure are considered as some of the main barriers for the slow uptake of EU funds for EE and RE projects by the applicants. In order to speed up absorption of the funds, national authorities have been **simplifying**

**the administrative process** for selecting and monitoring EU funded projects. This is a logical step to address the problem but needs to be made with some caution. Simplifying the administrative process should not imply loosening the application criteria for funding. This regards, for example, providing support for EE projects where the savings in GHG emissions are too low in relation to investment costs, or RE projects with significant negative impacts on the environment.

Some lessons can be drawn from the Green Investment Schemes (GIS) which are a new mechanism under the Kyoto Protocol where countries, after selling emissions permits to other countries, invest the profit into emissions reduction programmes by 2012. In the *Czech Republic*, in order to absorb the funding faster within the time limit, the government relaxed the criteria and now although applications are expected to start pouring in, the expected total emissions reductions will be lower than initially planned.

Therefore, the simplification of the application procedure must not endanger the quality of the projects: detailed applications requiring technical and environmental information are essential to **guarantee the robustness of the project in terms of achieved emission reductions and the transparency of the selection projects**. Solid criteria must be defined to assess climate performance of projects.

In *Hungary*, five sustainability indicators are monitored throughout the implementation phase of EE or RE projects. In the *Czech Republic*, EE and RE projects under the OP Environment are assessed according to their renewable energy capacity, decreasing energy consumption and CO<sub>2</sub> emissions cuts.

In *Latvia*, a number of complementary corrective actions aiming to speed up and simplify the project selection of EU funded projects were also undertaken. They involved simplifying the project application forms, making administrative and reporting requirements simpler, providing consultations, avoiding the doubling of required information, and shortening the time in which the payment requests are being processed.

Latvia's experience with the GIS sets a good example also in designing the project selection process so that projects which would achieve the highest GHG emissions reduction in the most cost efficient way will score the highest in the

ranking process. Another important feature is that there will also be ex-post monitoring of the actual achieved energy savings over the subsequent five years. In cases where the required minimum level of savings is not reached, the applicant will have to repay the money or invest their own resources to achieve the necessary minimum level of energy savings.

In *Poland*, the National Fund for Environmental Protection and Water Management is a good example of efficient public spending. It provides financial support to renewable energy and high-efficiency co-generation investments in Poland. The programme is expected to provide up to EUR 375 million loans to large-scale projects between 2009 and 2012.

An important feature of the programme is that debt incurred by beneficiaries to finance RE or cogeneration installations can be partially cancelled by the National Fund when a project has been successfully implemented and its environmental benefits have been assessed.

The first call programme has already received a large number of applications. Projects are selected according to their cost efficiency. By ensuring that the less costly of two equivalent projects is selected, this criterion allows for maximising the effects of the funding programme. The evaluation is made quicker and more transparent, as subjective criteria are not applied. The cost efficiency of a project is calculated against indicators such as the dynamic generation costs (DGC) or the average incremental cost (AIC). The data used for these indicators – investment costs, operational and maintenance costs, annual electricity/heat production of the installation, GHG reduction etc., – can be verified relatively easily.

Therefore, two sets of criteria should be used to assess the quality of a climate project: on the one hand, the “hard” criteria determining the project’s expected effects on the climate and the environment (GHG emissions, energy use, land use, water use). On the other hand, “soft” criteria assessing the project’s financial quality (cost-effectiveness, financial sustainability) and its quality in terms of governance and transparency, its impacts on jobs, social cohesion and its public acceptance and the degree of consultation in its preparation.

In Latvia, the measures helping to fund insulation in multi-apartments and social residential buildings have had positive climate as well as

social impacts. As they typically target decaying collective buildings inhabited by low-income people, these energy saving measures have a role to play in improving social cohesion.

### 3) Guarantee easier access to funding

Another major problem identified in the research, especially for private individuals, municipalities and SMEs, is the lack of fresh money. What is needed is simply a massive public intervention in the form of green public procurement and massive public subsidies for private and public housing. Although the EU can play the steering role and release the money, the implementation has to be done at local level.

Alternative sources of funding can **complement the EU co-financing**. In *Poland*, the National Fund for Environmental Protection and Water Management offers subsidies for co-financing EU projects. The role of banks for providing co-financing to EU funded projects is also essential. The Fund for Thermo-modernisation and Renovation of the Polish state-owned bank BGK grants conditional funding for insulation and the modernisation of the heating network.

**Combining different sources of funding** allows covering measures for energy efficiency in different sectors of the building stock. In the case of the Czech Republic, for example, EU funds can finance EE and RE in public buildings, whereas other national funds are available for blocks of flats and the Green Investment Scheme (GIS) provides funding for family houses. Hence, the combination of different sources of funding allows EE and RE measures to take place in all of the major types of non-commercial buildings.

The **early payment of grants** (during the implementation of the project) is already in place – with success – in some countries and for some measures. Such flexibility is a strong guarantee for applicants with limited financial capacity.

## 5. Conclusions and recommendations

The EU structural and cohesion funds are one of the most important fiscal instruments for regional development, especially in new Member States overcoming economic disparities and delivering social cohesion. In other words, the way EU

funds are spent significantly determines the development pathway of these countries. In this respect, EU funds have the potential to steer the transition towards low carbon futures in many new Member States.

In 2006, when the EU funds Regulations for the current programming period 2007-2013 were adopted and later when Operational Programmes were designed and approved, climate change mitigation was not considered high on the cohesion policy agenda, neither at the EU level nor in European regions. The meagre, unambitious EUR 4 billion out of EUR 177 billion was allocated to the countries studied in this report for energy efficiency and renewable energy projects for a period of seven years. Since then, however, the policy agenda and socio-economic context have significantly changed.

The EU Climate and energy package was adopted in 2008, setting up binding targets for 20 percent emissions reduction and 20 percent renewable energy in the energy mix. The implementation of this legislation will require significant financial resources at regional and local levels, and EU funding with its leverage effects will have a lead role in meeting these targets. Meanwhile, a raging economic crisis and soaring unemployment have urged EU policy makers to seek for greener and more eco-efficient pathways to development, duly reflected into the draft future high-level EU 2020 strategy presented by President Barroso to the European Council in December 2009.

Coming in the midterm of the current period 2007-2013, this report takes stock of the implementation of EU funded projects in the field of EE and RE in selected new Member States. It shows that some new Member States have chosen “smart-green” stimulus anti-crisis measures recognising the role that can be played by EU funds in EE and RE projects to help find a way out of the crisis, lowering energy bills, creating new employment opportunities and stimulating green businesses. In general, the demand for EU funding for such projects is steadily rising especially in times when national budgets are shrinking and banks are less willing to provide easy loans.

At the same time, however, a combination of the limited capacity of managing authorities, a lack of co-financing and upfront investment and the complicated application process and criteria are resulting in the dramatic implementation deficit of EU funded EE and RE projects. The analysis of spending shows that only 16.3 percent of

the total allocated EU funds for EE are absorbed by September 2009. For RE, the absorption is even lower – a mere 5.7 percent of the total RE allocations.

The report provides numerous country examples to show different experiences from the selected new Member States. However, the general trend shows that EU funds for EE and RE by September 2009 had been absorbed at a snail’s pace. The report also offers examples of actions undertaken in some countries to address these absorption barriers and improve the uptake of EU funding. Effective implementation already in the midterm of the current 2007-2013 period is crucial in order to accommodate the genuine investment needs of these countries and lay down the ground for effective programming for the post 2013 period.

The report has underlined the problem of comparability of data across countries. Different countries publish different data about EU funds approval, contracting and the actual spending on EE and RE projects which can turn cross-country comparisons into a real challenge. Furthermore, data about emissions reductions from EE and RE measures funded by EU funds is not publicly available.

Given the growing importance of EU funds in tackling climate change via direct support for EE and RE projects, unified reporting guidelines need to be developed by the Commission for all EU funds recipient countries. These reporting requirements need to provide for a coherent and comparable database on the total contribution of EU funds for EE and RE measures but also for accounting and verification of the actual emissions reductions from all of these projects.

## Policy recommendations

1) Member states should ensure that absorption barriers are overcome in order **to accelerate the implementation of EU funds for EE/RE**. As the barriers vary from country to country, an individual approach must be applied in each case. However, solutions to the most common problems can be worked out with the active involvement of the European Commission.

2) **Member states should increase their allocations of EU funds for EE/RE already within the current programming period**. Mid-term evaluations and shifts in allocations should reflect the rapidly increasing priority given by the EU to climate change mitigation and adaptation,

as well as the high interest of applicants in such projects. The European Commission should more actively encourage immediate shifts.

3) Member states should ensure that **projects in the field of EE/RE are selected according to adequate quality criteria**. A good balance between simplifying the administrative burden and achieving deep cuts in emissions needs to be found. Further **mainstreaming of EE/RE measures in other cohesion projects** should be made imperative through modifying project selection criteria and green procurement. The European Commission and its representatives in monitoring committees should actively promote good practices and benchmarks.

4) The European Commission should put forward a proposal for an **ambitious reform of the post-2013 cohesion policy**, revisiting the allocation criteria for EU funds in order to guarantee significant earmarking and the mainstreaming of EE/RE measures. The European Parliament should play an active role to ensure that future EU public spending delivers real climate-proofed regional development.

## 6. Annex 1: National case studies

### 6.1 EU Funds and climate in Poland

Allocations of EU funds in Poland for projects directly contributing to fighting climate change (production of energy from renewable sources and increasing energy efficiency) remain alarmingly low in view of the country's current energy portfolio and wasteful use of energy. Anti-crisis measures taken by the government did not include shifts in EU funds allocations and such moves are not on the political agenda.

Even though at the time of compiling this report the overall absorption of EU funds for 2007-2013 in Poland is very low in cases involving all types of projects in the field of infrastructure and environment, still, the implementation of RE/EE projects is even relatively less advanced. This slow beginning of implementation doesn't, however, seem to be a threat to the absorption of EU funds planned for investments in RE and EE in 2007-2013 – the allocations are low and the demand is

relatively high, so one can expect, that at least in the majority of RE/EE measures the funding will be applied for and contracted quickly, as soon as formal and institutional capacity barriers are overcome. In measures where competitions have already been held, the demand for funding exceeded many times the available allocation (with the most spectacular case of projects for improving energy efficiency in public utility buildings). Therefore, low available allocation remains the biggest barrier in achieving the substantial climate proofing of Poland's economy with the use of EU funds.

In view of the limited allocations from EU funds, national funding for both RE and EE remains an important option. In response to the economic crisis, the National Fund for Environmental Protection and Water Management has launched a loan programme for production of energy from renewable resources. In the field of energy-efficient refurbishment, funding for housing has been provided continuously for the last 10 years – EU funds are available almost exclusively for public utility buildings.

### Overview of analysed Operational Programmes

EU-funded projects in Poland are selected in competitions or named by Managing Authorities as strategic, 'individual' projects under various Operational Programmes.

The **Operational Programme Infrastructure & Environment** (OPIE) is Poland's largest EU-funded programme, and in fact it is the biggest single programme of this type in EU history, with an allocation of EUR 27.9 billion from the Cohesion Fund and ERDF (national co-financing is EUR 9.7 billion).

OPIE includes investments in a large variety of sectors (listed from largest to smallest allocation): transport, environmental protection, energy, higher education, culture and health care. Implementation of this programme will have by far the biggest impact on the country's economy and development path, as well as on the environment and Poland's greenhouse gas emissions. One of the OP's indicators (used also in the NSRF) is the increase of CO<sub>2</sub> emissions by approximately 30 percent between 2004 and 2013. According to the Programme, the production of electricity from renewable sources should increase from 2.0% to 7.5% in the same time. The energy demand of the GDP should decrease by ca. 8% (from 0.27 to 0.22 koe/euro). Energy savings and, in some cases, directly CO<sub>2</sub> mitigation are project selection criteria only in measures directly related to EE/RE.

All other beneficiaries of this OP are only required to declare and describe how their project will contribute to EU environmental policy (including on climate change) and how energy efficient are the proposed technologies.

The energy efficiency of technologies applied in projects in the field of transport is a YES/NO criterion, so in practice it's a matter of declaration required for formal reasons, rather than a way to assess the climate impact of a project. Moreover, this energy efficiency relates to technologies used by the beneficiary rather than the nature of the project itself (e.g. the energy efficiency of constructing a road is – at least in theory – assessed, but not the climate impact of the new road due to the increase in car use).

In each of Poland's 16 regions a **Regional Operational Programme** is implemented, with specific regional priorities and projects smaller than in the national programmes. The joint allocation is EUR 16.5 billion. Measures more or less directly relating to RE can be found in all of the programmes, all Regional OPs include also support for transport.

**OP Innovative Economy** with an allocation of EUR 8.2 billion can contribute, in theory, to an increase in use of renewable energy sources or better energy efficiency, through direct investments in innovative technologies in enterprises, as well as research & development projects. However, RE or EE related projects are not a separate measure under the programme. Therefore, the impact of this programme on climate change is difficult to assess and rather marginal – the list of current beneficiaries shows only a few single project titles clearly relating to RE/EE among almost 2000 projects contracted as of October 2009. A few relevant projects can be found in the individual project list.

Transboundary, transnational and interregional programmes under the objective of **European Territorial Cooperation** (allocation of EUR 557m) provide opportunities for the transfer of experiences, including pilot projects, possibly also in the field of RE/EE.

**OP Human Capital** implements the entire allocation of the European Social Fund for Poland in 2007-2013 (EUR 9.7 billion). While the main goal of the programme is the increase of employment and social cohesion, RE/EE can be a topic e.g. for stimulation of 'green job creation' or capacity building. By October 2009, over 10 000 contracts for projects have already been signed, and over 1000 projects have already been completed. Among them, at least a

dozen projects are directly connected to renewable energy sources in rural areas. A more detailed analysis is difficult due to the large and quickly increasing number of approved projects and lack of detailed data apart from project titles.

## Energy savings and renewables in the EU Funds

Poland has not taken any action to shift funding towards RE/EE. In a letter of July 6, 2009, received by Bankwatch from the Ministry of Regional Development, there is no indication that such a shift in OP Infrastructure & Environment is neither seriously considered nor or known when it could happen. Possible changes in Regional OPs are subject to decisions made by the regional authorities. One reason for a reluctance to shift funding within OPs may be the general low absorption – shifts are much more likely to happen when the money for some measures is already absorbed, while in others there is a threat of not absorbing the allocation in time.

Absorption in measures directly related to RE/EE is slow (competitions held in three out of seven measures, two ranking lists), however, given the low allocation, it seems that the funding will be disbursed relatively fast (in some measures, within the first organized competition). In measure 9.3 (energy efficient refurbishment of public utility buildings), financing all good-quality projects (approved and reserve list) submitted in the first round would require ca. four times higher allocation. This proves the high demand for energy efficiency projects.

Production of energy from RE (9.4) also proved to be popular among beneficiaries. The measure includes biomass, wind and hydropower projects, however, wind projects have dominated the ranking list of approved projects.

Barriers to implementation:

- general barriers applying to all EU programmes – slow start (capacity, bureaucracy)
- state aid: for measures involving state aid, a state aid programme must be accepted by the European Commission (after decisions of the EC in July 2009, now all measures can be implemented).

According to an official of the Ministry of Economy, EU funds for the energy sector are in general implemented slower due to the necessary approval of state aid programmes by the European Commission.

A significant barrier to the implementation of some wind and hydropower projects can be their clash with nature protection and the Natura 2000 network, if not located properly.

## 6.2 An example of good practice: Bio-energy in the Bystrica region, Slovakia

Friends of the Earth-CEPA selected the rural region of Severne Podpo anie, Central Slovakia for its programme called “from external dependency towards community-serving local economies” to start a pilot process of stabilization and future development of its economy. This area consists of 10 municipalities with a total of 5600 inhabitants. Although the local economy has almost collapsed during the past decade and the unemployment rate exceeds 15%, the area has the potential for sustainable development, e.g. in the use of renewable energy or soft tourism.

An association of villages and towns joined together to provide for mutual heating in municipality premises using wood remains and chips from sawmills. The project will benefit from approximately EUR 6 million from the OP Environment.

One of CEPA's first steps in this process is to replace 13 obsolete electricity/coal boilers in 32 public buildings with modern boilers based on woodchips from local production. Currently, most of the existing boilers that heat local schools, municipal offices and other public facilities in the micro-region are old and inefficient and require reconstruction anyway. Increasing energy prices force municipalities to limit the use of their facilities and represent a significant burden for municipal budgets.

The fuel will be produced in municipal facilities from the currently unused wood waste in local sawmills. This will not only reduce annual municipal expenditures for heating but also prevent the permanent outflow of public finances from the region. Support from the EU structural funds and state co-financing programmes that are earmarked for renewables may substantially increase the benefits for the region. Savings can be allocated, for instance, for micro-finance schemes to support local entrepreneurship.

If successfully implemented, the lesson learned from the pilot project may be introduced in dozens of other marginalized rural regions in Slovakia with similar natural conditions needs. The project

may also provide a powerful argument for CEPA's campaigns to ensure sufficient financial allocations for small-scale rural renewable projects from the Structural Funds in the next programming period and to shift the criteria for the provision of public subsidies from the quantity of planned investments towards their quality and benefits for underdeveloped regions.

## 6.3 Green Investment Scheme, Latvia

Currently Latvia has sold emission permits to Austria (2 million AAUs) and the Netherlands (3 million AAUs). Another contract about selling of AAUs has been made with Spain on September 3, 2009 (5 million AAUs sold) and in October it would be also concluded with Japan and some more deals are to come up.

The deals with Austria and the Netherlands brought EUR 50 million revenues. After deals were concluded the Government of Latvia negotiated in detail with buyers on what kind of measures would be supported. For every measure separate Cabinet regulations are to be elaborated laying down detailed goals for the measure, conditions for project applications and the projects' evaluation criteria.

The first measure was “Increase of energy efficiency in municipal buildings” whose by-laws were approved on June 25, 2009 with the Cabinet Regulation No 645. The total available public financing for that tender was EUR 25 million. The tender was open from July 28 until August 24, 2009. The tender was aimed at increasing energy efficiency in municipal buildings. The goal of the tender was GHG emission reduction by decreasing heat energy demand in public buildings owned by municipalities or those needed for carrying out municipality functions.

The maximum co-financing rate is 85% from eligible costs and the remaining 15% needs to be covered by the applicant (municipality). The project implementation should be ensured not later than by December of 2010. During project implementation there are advance payments provided (up to 50% at the start-up and then also one or more mid-term payments but not exceeding 90% of total eligible project costs) in order to minimise financial burdens on municipalities that are implementing the projects.

The project evaluation criteria are designed in a way to ensure that there will be significant heat energy

demand achieved, and CO2 emission reduction would be done in a cost efficient way. For example, there is an administrative evaluation criterion that demands that as a result of project implementation (after doing heat insulation) there should be at least 25% of annual heat energy demand savings ensured in each of the buildings ensured compared to average annual heat energy consumption in the period from 2006 until 2008. Another administrative criterion within project assessment process is cost efficiency of CO2 emission reduction – the minimum threshold of CO2 emission reduction against invested money that needs to be ensured can't be less than 0.25 kg of CO2/per 1 Latvian lats (or 0.176 kg of CO2/per 1 EUR that was invested in the project).

A main quality criterion for assessing the project applications was the achieved reduction of CO2 emissions in a cost-efficient way. Thus projects that would achieve the highest CO2 emission reduction against the invested money would score higher in the project evaluation process.

The Ministry of Environment organised a seminar in the beginning of August to explain the requirements, preparation process of project applications as well as project selection and evaluation criteria.

Another interesting feature of the measure is that the project applicant is liable for achieving the minimum required CO2 emission reduction, thereby ensuring the minimum threshold of cost-efficiency is reached. There will also be ex-post monitoring of the actual achieved energy savings over the next five years. In case the required minimum level of ensuring at least a 25% savings in heat demand for each building, then the respective municipality would be asked to repay the money (calculating the difference between the minimum savings that was used as administrative criteria and the actual performance) or to invest their own resources to achieve the minimum necessary level of energy savings.

There was quite a high number of submitted tenders. There were 69 project applications received that involved the increase of energy efficiency for 253 buildings. In total LVL 29.95 million (Latvian) (EUR 42.62m) were required. Out of the 69 project applications that were submitted 56 project applications passed the administrative evaluation stage involving 222 buildings for the total amount of LVL 26.10m(EUR 37.14m). The currently available funding allows the financing of 35 projects.

The energy efficiency measures will be applied in schools (43% of the funding); kindergartens (39%) and

other municipal buildings like cultural houses; health care centres and hospitals, public libraries, etc. As there is not enough funding available, those projects that lack financing from this tender (there was EUR 25 million available) will be put on the 'waiting list'. When there is additional money available from other deals from selling AAUs, then those projects would be financed. Considering that the current prices of construction work has decreased substantially, then some of the projects may actually turn out cheaper than envisaged before and that would allow financing more projects and ultimately achieving higher savings in CO2 emissions.

Three more deals for selling AAUs are to be concluded in the autumn of 2009 and roughly the same amount of revenues is expected. EUR 25 million from the first round of applications was allocated for increasing energy efficiency. Apart from that there are other measures that will be supported through GIS in Latvia where tenders will be open in 2010 and 2011:

- 1) Increase of energy efficiency in state owned education buildings – EUR 10 million;
- 2) Increase of energy efficiency in secondary education buildings – EUR 29 million;
- 3) Transition technologies from the use of fossil fuels to renewable energy resources (RE) – EUR 7.70 million;
- 4) Development of technologies aimed to GHG reduction – EUR 5 million;
- 5) Pilot projects for passive housing – EUR 7 million;
- 6) Reduction of GHG in car transportation – EUR 3 million;
- 7) Integrated projects for increasing energy efficiency and technological development in production facilities – EUR 15 million;
- 8) Changing lights in municipalities – EUR 3.688 million.

## 6.4. Green Investment Scheme, Czech Republic

The Green Investment Scheme (presented as Green for Savings program in the Czech Republic) is a public grant funding scheme run by the Ministry of Environment and managed by the State

Environmental Fund. It was launched in April 2009 and will run to the end of 2012. Its funding comes from the sale of 64 millions surplus Kyoto emissions allowances (AAUs) for 640M€ to Japan and other buyers. Czech government hopes for earning about 1bn€ in sales of total 100 millions of AAUs to other countries up to 2012. The conditions of a Green Investment Scheme are not set by the Kyoto Protocol, but negotiated between the buyer and seller and fixed in the GIS agreement. In this case, Czech government is responsible for the realization and compliance. The agreement allows some degree of flexibility of the conditions, which has been used by the Ministry of Environment to loosen originally strict conditions for financing after the initial phase of the programme brought an insufficient number of applications. In case the Czech Republic is not able to spend these funds by 2012, it must return them to the Japanese government and get the proportion of AAUs back – these will be unusable as 2012 is the end of the trading period under the Kyoto protocol.

The programme is aimed at providing up to 50% co-financing to 250.000 private household renovation projects: house insulation, window replacement, installation of renewable heating, boiler or water heater replacement, support for passive energy construction. The estimated benefits are quite high: up to 1MT CO<sub>2</sub> annual emissions reduction and creation of 30.000 potential, especially in SMEs. It should also reduce emissions of dust by up to 2 million tons and save up to 6 million GJ of heat, an equivalent of 200 million tons of gas.

The launch of the programme was a major event in the media and on the first day, the programme website crashed under the amount of visits. Thousands of questions were answered by the info line of the State Environmental Fund. In spite of this, only 205 applications were registered in four months. As a result, on 17th August 2009 the Ministry of Environment loosened the rather stringent conditions of the program in order to attract more applicants.

The low number of applications was probably due to several reasons. Some of are related to the start of the program, when neither officials of the State Environmental Funds, nor companies and banks nor the applicants were well prepared. Banks, now providing special loans for the program came with their offers only after two month. The announcement of the Ministry that it would loosen the conditions also encouraged applicants to delay their application.

For many, the rules were too strict and required too much investment. Originally, the estimated overall

investment necessary to realize all the measures in order to comply with the program conditions was quite high. For a typical family house, to complete insulation and turn to biomass heating would cost about 25.000 Euro with a Green Investment Scheme support of about 40%. Under the current economic crisis, people were not willing to do this spending now. Under the new conditions, fewer measures in the project should be enough to be able to apply for the support. The maximum range of support has grown to up to 50% and cost of the project can now be included. Payments can also be provided beforehand, reducing the necessity of a loan. With the new rules, minimum investment of about 8.000 Euro in a typical family house should be enough to apply for the support from GIS. Blocks of flats (concrete panel houses), that were originally not eligible for the support can now be supported as well with significant number of applications filed.

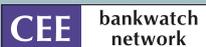
Some other reasons might persist even with the new conditions. The whole project cycle – planning, realization and evaluation – must be carried out by authorized companies, which leads to extra costs. Projects can only be realized by building companies with a special license for each insulation system. This brings an extra administrative burden for small local companies. This licensing comes on top of what building companies have to prove when registering by the Trades Licensing Office. For some insulation systems, only few companies are registered, which disables the competition.

After the change of conditions and some time necessary for designers to prepare the projects, application now started pouring in high volumes. By February 2010, more than a billion CZK (€ 400 million) has been allocated into projects, with half of it allocated only in the last 20 days. The State Environmental Fund has speeded up the processing of the applications and with current speed, the € 640 million will be allocated well before the end of the program in 2012. With this perspective, and also with buyers of the allowances satisfied with palpable results, the Ministry is now preparing sales of more allowances to increase funds for the Green Investment Scheme. Despite of initial slow start and loosening conditions on detriment of environmental integrity of the Green Investment Scheme, the program showed out to be a major success and a boost both to energy efficiency of the housing sector and public acceptance of efficiency measures.

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