Financing Sustainability at EU level: state of play and key challenges

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Abstract:

European Union (EU) policy in the field of sustainable development has a long-standing tradition. The debate has been renewed with the approval of Agenda 2030 at international level. New scenarios for the European Union are in discussion under the next Multi-annual financial framework, with clear budgetary implications. The EU budget has financed sustainable development through a large range of policy instruments over the last period, including grants and financial instruments. Examples of sustainable development interventions in cities and regions financed with a EU support are many. However, how to finance sustainable development is subordinated to the definition of what sustainable development means in the various EU policy contexts. In the next future the involvement of the private sector supplementing public intervention would probably be determinant to achieve sustainable development in some key policy areas.

Keywords: EU policies, EU budget, Sustainable Development Goals, Financial instruments

JEL Classification: G11, Q01, Q56, O13, R11

1. Introduction

Sustainable development has been part of the EU policy debate at least since the Rio conference (1992). Initially sustainable development was mainly associated with a way of 'greening' EU socio-economic policies[1], before being considered as a goal guiding EU internal and external policy[2]. For the last 20 years, there has been a proliferation of strategies, action plans and programmes referring to 'sustainable', 'sustainability' or 'sustainable development'. However, the primary legislative texts (Treaties), as well as secondary legislation sources such as regulations, directives and decisions, do not and cannot adopt a unified definition of sustainable development (KENIG-WITKOWSKA, 2017). This is partly because its implementation is strictly context-specific and should adapted to the specific needs of people.

In the policy framework, sustainable development has been addressed mainly through general principles guiding policy interventions[3]. How they are combined to reach a sustainable development pathway depends largely on the legislative and planning context. Similarly, the

[1] Treaty of Amsterdam (2007) article 3: 'Environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, with a view to promoting sustainable development'.
[2] Lisbon Treaty (2009), Article 3 'The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance'.
[3] The guiding principles mentioned in the 'renewed EU Sustainable Development Strategy (EU SDS) 2009'are: policy integration and coherence, impact assessment, polluter price principal, precautionary principle, best available technology, involvement of business and social partners, involvement of citizens, promoting and protecting fundamental rights, solidarity within and between generations.

question of 'how to finance sustainability?' depends on the specific policy instrument and the definition of the term in EU policies which contribute to sustainable development.

In this paper, financing EU sustainable policies is addressed at both macro and territorial levels by considering current discussions in the EU related to the sustainable development strategy to be adopted beyond 2020. Moreover, examples of cities and regions with sustainable development interventions supported by the EU budget are provided.

2. Scenarios for sustainable development beyond 2020

Sustainable development in the current policy framework

Taking stock of experiences gained over the last ten years of implementing sustainable development, the current policy debate at EU level has recently embraced the approach designed under the UN Agenda 2030 four years ago. This identified 17 Sustainable Development Goals (SDGs) and 169 associated targets, addressing five priorities: People, Planet, Prosperity, Peace, Partnership.

These cover a broad range of fields and development issues such as transport and urban issues, consumption and production patterns, energy, biodiversity and climate change, poverty and health, education and equity, water and desertification, agriculture and food security. SDGs include targets related to the fight against poverty set by the Millennium objectives in the early 2000s. Two SDGs refer directly to economic development, six are social, seven are environment-oriented while two focus on policy governance.

Figure 1: The 17 Sustainable Development Goals

Source: UNITED NATION (2015).

It is worth noting that the 17 SDGs are naturally integrated. Development issues such as poverty, human rights or environmental quality are indivisible and cross-cutting by essence, as already illustrated in the Brundtland report (1987). In that direction, the Communication 'Next steps for a sustainable European future – European action for sustainability' was published in 2016. In it the European Commission (EC) identified five key actions for effectively implementing the 2030 Agenda:

- Inclusion of SDGs in EU policies and initiatives;
- Regular reporting of progress;
- Set-up a multi-stakeholder platform to follow-up and exchange best practices;
- Prepare a long-term post 2020 vision document, and
- Disseminate 2030 Agenda implementation to other European institutions and national governments, as well as international and civil society organisations.

Integrating policies is ensured by a multi-sector approach with broad stakeholder participation in defining and implementing SDGs at all levels of the policy making process as well as monitoring progresses towards targets (Meuleman, 2018). Definition of a long-term vision means different policy scenarios for the new Multi-annual Financial Framework (MFF) 2021-2026 as identified by the Junker Commission (EUROPEAN COMMISSION, 2019). The scenarios are still under discussion in the European institutions and cover:

- An overarching SDG Strategy to guide all actions of the EU and its Member States. This is in line with recommendations from the High-level Multi-stakeholder Platform on SDGs[4]. Under this scenario a large part of EC and Member State budgets should be allocated to policies contributing to SDGs. Strong coordination mechanisms are needed between levels of governance, especially Member States and the EC as well as between institutions, policy instruments and funds;
- Continued mainstreaming of the SDGs in EU policies, but not enforcing Member State action in this direction. Member States should be free to define their own degree of commitment to SDGs. Moreover, financial allocations to SDGs should by defined within the MFF (see Table 1below)[5] and financial commitment from Members States should be variable;
- Prioritising EU external actions to promote SDGs outside the EU, while consolidating sustainability ambition at EU level. In this scenario financial allocations to SDGs are only part of the EU budget (see Table 1 below), with a likely focus on SDG 11, Sustainable Cities and Communities.

To clarify the links between current EU policy and the priorities in Agenda 2030, the EC reviewed all on-going policies in force for 2014-2020. The unsurprising results show that most EU policies cover at least one SDG, with all the priorities being addressed under Agenda 2030. The current EC budget for 2014-2020 of some 1 000 billion euro should be consistent with the 17 SDG themes (see table below).

[4] Created in 2017, the Multi-stakeholder platform aims to support and advise the EC and all stakeholders on the implementation of SDGs at EU level.
[5] The EU long term planning financial instrument defining fields of intervention for EU institutions and the budget priority over a period of 7 years (The financial framework for the period 2021-27 is currently under discussion).

Table 1: Relevance of MFF 2014-2020 to SDGs (EUR billion, 2011 prices)

MFF 2014-20	Amount 2014-20	Related SDGs
Smart and inclusive growth	**490.908**	
Competitiveness for growth and jobs	114.888	8, 9
Economic, social and territorial cohesion	376.02	All (except 17)
Sustainable growth, natural resources	**382.927**	
Common agriculture policy (market exp. + direct payments)	281.825	2
Rural development	89.895	All (except 17)
Fishing and maritime policy	6.685	14
Environment and climate actions	3.2	6, 7, 11, 12, 13, 14, 15
Pilot projects and preparatory actions + other	1.321	-
Security and citizenship	**18.535**	
Asylum and Migration	3.433	16
Security and Justice	5.258	16, 17
Right, citizenship, civil protection, Europe for Citizens	0.835	4, 5, 16
Food and feed, Health for growth, consumer protection	2.748	1, 2, 3
Creative Europe	1.59	16
Others (e.g. decentralised agencies)	4.672	-
Global Europe	**70**	
Neighbourhood policy + IPA	28.617	10, 16, 17
Development Cooperation and Partnership	21.597	10, 16, 17
Democracy, Human rights, Stability	3.91	1, 2, 10, 16, 17
Humanitarian aid and Foreign and Security polices	8.915	1, 2, 10,16, 17
Nuclear protection	0.56	-
Civil protection and Aid volunteers	0.42	10, 16
Other	5.982	-
EU Administrations	**62.629**	-
Total - €	**1,025.00**	-

Source: own elaboration; financial figures: a budget for EU 2020, EUROPEAN COMMISSION (2011).

However, thematic consistency with SDGs does not imply that the EU policy framework is sustainable *per se*. For example, not all interventions under the Common Agricultural Policy for example contribute to climate and environmental objectives. In addition, investments under the European Regional Development Fund (ERDF) are not all environment oriented and sustainable principles are not automatically taken on board by the projects supported by Horizon 2020, COSME or the Youth Initiative. Many interventions are implemented on a 'silo' approach, so they target few priorities without clear cross-connections between themes, they may also involve a limited number of stakeholders and authorities, and focus on specific fields or sectors of expertise and competence.

Sustainable development in cohesion policy 2014-2020

European and Structural Investment Funds (ESI) Funds cover ERDF, the European Social Fund (ESF), the European Maritime and Fisheries Fund (EMFF) and the European Agricultural Fund for Rural Development (EAFRD). The Common Provisions Regulation (CPR) 1303-2013 regulating the use of ESI Funds and sets out 11 thematic objectives (TOs) contributing to better territorial, social and economic cohesion in the EU (in reference to article 174 of the TFEU). The TOs also support the achievement of EU 2020 objectives, which aim for smart, sustainable and inclusive growth[6]. The sustainable growth objective covers TOs 4 'Low carbon economy', 5 'Climate change adaptation and risk management', 6 'Environment and resource efficiency' and 7 'Sustainable transport and network bottlenecks', but sustainability is also identified as a cross-cutting objective to be pursued under all TOs[7]. ESI Funds involve all Member States and are implemented through 28 national Partnership Agreements, approved at national level, and more than 290 regional programmes. Each programme defines its own strategy, including implementing tools, and investment priorities based on regional needs consistent with financial resources and administrative capacities. In all operational programmes, specific criteria related to sustainable development are used for project selection as applicants are required to demonstrate how their project intends to contribute to sustainability. The regulations also require monitoring, evaluation and regular reporting on sustainable development in programme implementation[8]. The TOs with the highest percentage of funding are TOs 3 'SME competitiveness', TO 6 'Environment and resource efficiency' and TO 7 'Sustainable transport and network bottlenecks' with more than 45% of resources being allocated to the sustainable growth objective[9] (see Table 1 above).

More specifically article 7 of the ERDF regulation (Reg. 1301/2013) established that at least 5% of each Member State's allocation shall be devoted to actions for sustainable and integrated urban development (SUD). In addition, article 8 foresees Urban Innovation Action providing specific financial support to cities for sustainable development. An estimated € 15.5 billion is allocated to SUD. Of this, € 14.2 billion (92.5%) is to be financed by ERDF and € 1.3 billion (7.5%) by the ESF (in multi-fund programmes). About half of that amount is delivered through Integrated Territorial Instruments (ITI).

Financing Sustainable Development from ESI Funds

The main EU financing tools for sustainable development in cohesion policies are direct subsidies in the form of grants to public or private organizations, or financial instruments (FIs)[10]. The choice of financing tools is left to the managing authority through the operational programmes where they allocate funds to private and public organizations. The EU financing rate depends on the regional level of development and the objectives pursued by the programme. Support for enterprises is also regulated by State aid thresholds which limit public incentives allocated to private economic operators[11].

[6] TOs cover the following themes: Research and innovation (TO1); information and communications technology (TO2); SME competitiveness (including rural businesses, fisheries processing and aquaculture) (TO3); low carbon economy (TO4); climate change adaptation and risk management (TO5); environment and resource efficiency (TO6); sustainable transport and network bottlenecks (TO7); employment and labour mobility (TO8); social inclusion and poverty (TO9); education (TO10) and institutional capacity (TO11).
[7] Sustainable development as a 'horizontal principal' should ensure the mainstreaming of sustainable development into ESI Funds in all phases of implementation, as mentioned in section 5.2. of the Common Strategic Framework in annexe 1 of the CPR.
[8] Article 54 of the CPR
[9] See table 2 in Review of the adopted partnership agreements. Mention also cohesion policy open source platform.
[10] See Fi-compass (2015*a*).
[11] See Fi-compass (2018).

FIs have been introduced in ESI Funds at a large scale more recently and are mainly guarantees, loans and equity instruments[12]. FIs can cover any of the eleven TOs defined for the 2014-2020 period. Compared to grants only, they can bring significant additional benefit to public support for sustainable development objectives:

- FIs have to be paid back by beneficiaries, so public authorities can re-invest the resources multiple times in different projects (the 'revolving effect').
- They seek to attract additional public and private resources for investment in projects through co-financing and co-investments at fund or project levels (the 'leverage effect'). This increases the capital available to public authorities and territories for investments.
- They can be an incentive to selecting better quality projects, because of the greater efficiency needed to repay the support. Moreover, involving the private sector enables the public sector to gain financial and managerial skills in identifying investments suitable for FIs, as well as in assessing the financial and non-financial impacts of investments. These skills can help more broadly in efforts to improve the efficiency of public fund support.

However, the effectiveness of financial instruments should be framed within the overall context of alternative policy instruments. Grants are intended as transactional support, essentially non-recoverable 'one-off' subsidies or payments to beneficiaries with no requirement to repay or return any financial costs to the public sector. Given the requirement to repay, FIs can be more complex to implement and not appropriate for every context[13]. The major challenge is related to the need to clearly define what sustainable development investments are from an FI perspective and how much private investors can contribute to SDGs in a broader view.

3. Financing from EU funding sources for sustainable development in regions.

Many regions and cities are already engaged in setting up Agenda 2030 strategies. As mentioned in multiple studies, a major obstacle to SDG policies is a lack of funding sources. Local and regional authorities (LRAs) defining a sustainable development strategy find it challenging to connect SDGs with regional, national and EU funding sources that ensure continuity and consistency of medium to long term finance needed to achieve the objectives[14].

Financing sustainable development projects with grants and financial instruments (from ESI Funds) has been tried in 2014-2020 in many Member States.

Example of financing sustainable development through grants at territorial level

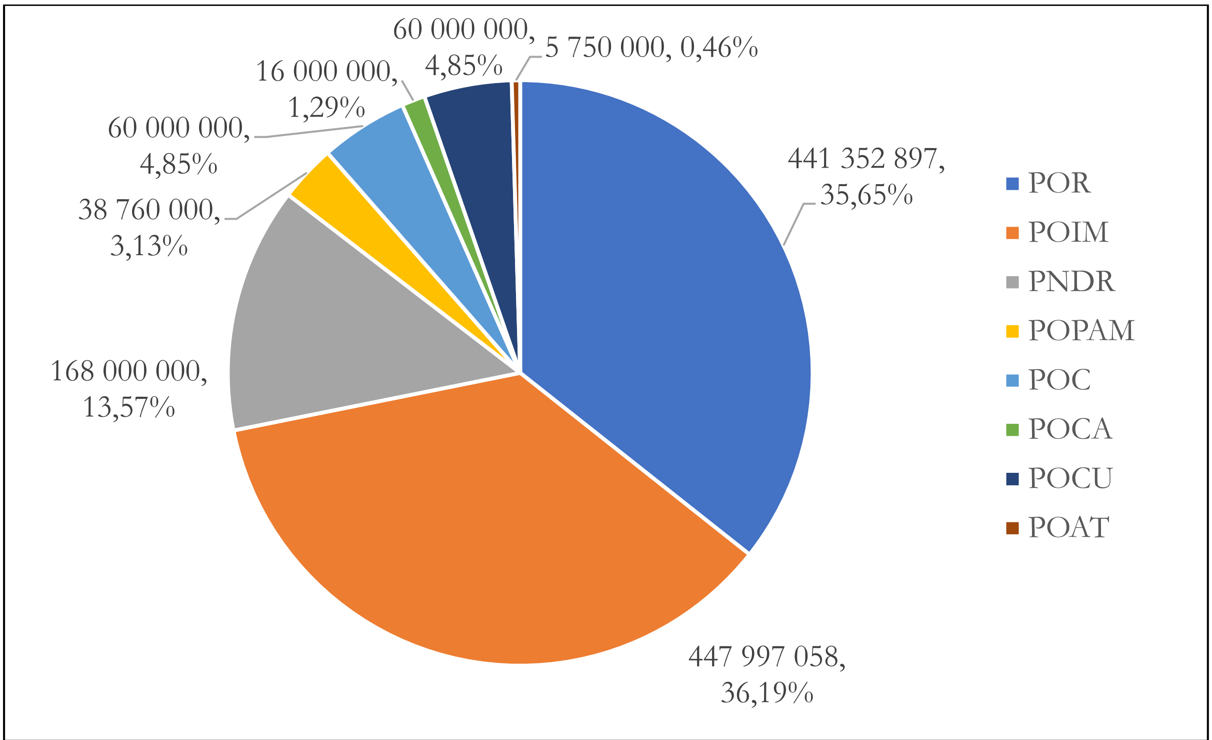
[12] See Fi-compass (2015*b*).
[13] See OECD (2017) and OECD (2018), *The theory and practice of financial instruments for small and medium-sized enterprises* and OECD (2018), *Financial Instruments in Practice: Uptake and Limitations.*
[14] See Levarlet *et al.* (2019).

Romania uses the ITI instrument in the Danube Delta Biosphere Reserve (DDBR). This territory has unique natural and cultural features, such as extensive wetlands, scattered settlements, economic specialisation and vulnerability as well as limited access to basic social services and infrastructure. The Integrated Strategy for Sustainable Development of the Danube Delta (SIDDD) looks to both protect the environment and develop the local economy.

The main characteristics of the ITI are:

- It is easier to run territorial strategies and promote a more local or 'place-based' form of policy making based on a multi-stakeholder approach. The ITI increases the role of local authorities, NGOs and other sub-national bodies involved in managing and implementing ESI Funds by helping widen capacities for conducting territorial development in a more sustainable way over the longer term;
- It addresses social, economic and environmental issues in an integrated approach at territorial level. It is structured around five closely interconnected pillars; Pillar I: Protecting the environment and natural resources; Pillar II: Improving economy; Pillar III: Improving connectivity; Pillar IV: Ensuring public services; Pillar V: Promoting efficiency, accessibility and sustainability (including administrative capacity of local authorities and technical assistance in implementing the program).
- Funding sources are varied and integrated in a coherent framework. The SIDDD was drafted with World Bank expertise together with local authorities and, for 2014-2020, is implemented through ERDF, EARDF, EMFF, CF and ESF (see Figure 2 below).

Figure 2: ITI Danube Delta financial allocation by Operational Programme



Source: ITI Danube Delta, http://www.itideltadunarii.com/Finantare

Two examples of financing sustainable development through FIs at regional level

There are several examples of public authorities using ESIF funded financial instruments to explicitly support sustainable development.

CAP *Troisième Révolution Industrielle* (CAP TRI) is an FI supported by the 2014-2020 ERDF Operational Programme in the region of Nord-Pas de Calais in France[15]. CAP TRI combines resources from ERDF, the European Fund for Strategic Investments (EFSI) with EIB funding guaranteed and private investors. CAP TRI invests mainly through equity in SMEs. This FI was developed to help Nord-Pas de Calais become the first carbon-neutral region in France by 2050. In 2013, the managing authority and the regional Chamber of Commerce and Industry jointly published a road map for regenerating the area through TRI. It targets 'zero carbon emissions' by 2050, looking for energy needs to be fully met through renewable energy sources. The FI finances projects that fit within the five pillars of the TRI road map: (i) renewable energy, (ii) smart buildings generating energy, (iii) energy storage, (iv) smart grids for energy, and (v) soft and smart mobility. Moreover, the FI adheres to the Principles for Responsible Investment established by global investors and supported by the United Nations. This incentivises investors to consider the environmental, social and governance principles of the companies they invest in.

The main characteristics of the instrument from a sustainable development perspective are:

- Leverage of public money. With initial investment funding of EUR 37.5 million, as well as EUR 2.5 million for technical support in the form of grants, the FI aims to stimulate investments of EUR 100 million in projects and is currently raising funds from public and private investors.
- Multi-objectives. The energy transition initiative should also result in job creation, economic development and less fuel poverty with more sustainable energy supply and usage.

The London Green Fund (LGF)[16] is another project supported by ERDF. It contributes to London's ambitious carbon reduction targets to make the city one of the world's leading low carbon capitals by 2025 and a global leader in carbon finance. LGF consists of three urban development funds investing in energy efficiency, waste and greener social housing. The ERDF contribution of EUR 60 million combined with public and private funds brings loan and equity funding for projects ranging from the city's first plastics recycling plant to energy efficiency upgrading in public buildings. This helps London's transition to a low carbon economy, which will bring economic opportunities in terms of jobs and inward investment.

The main characteristics of LGF are:

- A multi-objective purpose, to support sustainable economic growth by investing in low/zero carbon environmental infrastructure and premises, physical environmental enhancement and retrofitting existing buildings, including social housing. The beneficiaries include the Tate Modern art gallery, local authorities and a hospital.

[15] Fi-compass (2016).
[16] Fi-compass (2015).

- Multi-target groups. The loans and equities offered under LGF were open to the public and private sectors including voluntary and third sector bodies, private sector landlords, owner-occupiers, tenants, developers, energy service companies, joint ventures and special purpose vehicles.

4. Conclusions

The definition of future EU sustainable development policy is underway. Behind the discussion on ‘how to finance sustainability’, is a debate on the definition of sustainable development and its relevance in the EU policy framework in general. Embedding SDGs in EU policy would imply on one side to consider the budget implication and, on the other, to understand how to exploit the more financial opportunities for local sustainable development polices allowed by the availability of more resources in a broad sense.

Different scenarios on future EU strategy for sustainable development imply different amounts of financial resources allocated to sustainable development posing new challenges as well as new opportunities for public authorities on identifying the target (i.e. which SDGs to achieve in relation to territorial and people needs) and on setting-up the type of policy instruments to adopt (i.e. grants or FIs). The transversal aspects of sustainable development, in fact, imply various funding sources and mechanisms. There is no unique way to finance sustainability; it depends on the objectives, the policy fields and the beneficiaries targeted.

A large range of instruments are already applied at EU level, including both grants and FIs (considering that fiscal incentives are not under the competence of the EU). EU funding for LRAs is key to support successful local sustainable development pathways. Different instruments under the ESI Funds have been implemented at local and regional levels in rural and urban contexts, such as the Integrated Territorial Investment for an integrated sustainable development planning, Community-Led Local Development for a sustainable and place-based development in rural context or the Urban Innovation Action providing financial supports to cities for sustainable development. However, more guidance and technical support to implementing bodies and beneficiaries in using these instruments to reach sustainable development targets seem to be necessary to fully exploit their potential.

Using FIs to address sustainable development has been encouraged at different levels in the EU, to increase total support for sustainability. The main advantages of FIs are the leverage effects of private finance from public contribution and the revolving mechanism which address the question of long-term availability of financial resources. Not all SDGs can be supported through FIs, as FI implementation can require complex arrangements, skills and competences. Above all, loans, guarantees and investments in capital involve payback mechanisms which require investments to generate revenue. This can potentially increase also the quality of projects supported and better contribute to the achievement of SDGs.

On this aspect, the main challenge over the next years is to involve private investors at a larger scale and give clear instructions to markets to allow them to reach sustainable objectives in an effective, coherent and long-term framework. Recent EC guidelines have been published to regulate private involvement in this new field. Moreover, identifying ad-hoc financial solutions and mechanisms specifically designed for SDGs is another field of future research and debate, starting from the existing best practices currently implemented in European territories.

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