

THE COST-BENEFIT ANALYSIS AND THE ENVIRONMENT IN COMMUNITY STRUCTURAL FUNDS IN ITALY

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Abstract

This work aims to analyse how the application of the Cost-Benefit Analysis (CBA) in the Community Structural Funds helps the implementation of the horizontal principle of environmental sustainability in Italy.

Reg. 1260/1999 on Structural Funds for the cycle 2000-2006 requires a CBA for the so-called *major projects* – i.e. exceeding €50million. What stands out is that to appraise these *projects*, environmental components are scarcely considered, even if they are supposed to be a typical feature of a CBA. Nevertheless, the requirement for a CBA was relevant for the allocation of the 4% Community performance reserve in the Objective 2 regions.

The role of the European Investment Bank will be also checked: in the framework of the Community cohesion policy, the Bank has built an appraisal procedure that is reserved to co-financed interventions, which can be substantially considered equivalent to a CBA.

Finally, the impact of the provisions for the next programming cycle 2007-13 will be seen: the current proposal still provide for a CBA, but adds a financial distinction in terms of issues covered by the project, i.e. *major projects* are those whose total cost exceeds €25 million in the case of the environment and €50 million as for other fields.

This research activity was presented in occasion of the OECD Workshop on recent developments in environmental CBA, held in Rome, Italy, on 14-15 October 2004.

1. Major projects

It is well acknowledged that the **2000-2006 Community Structural Funds framework** defines *major projects* as those whose total cost taken into account in determining the contribution of the Funds exceeds €50 million. The Council Regulation 1260/1999 laying down general provisions on the Structural Funds requires the provision of some information, for the appraisal of the project, among which two seem to be of interest in terms of environmental concerns:

- a ***cost-benefit analysis***, including financial costs and benefits, a risk assessment and information on the economic viability of the project (art. 26 (d))
- information allowing an ***evaluation to be made of the environmental impact*** and the implementation of the precautionary principle and the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay and compliance with the Community rules on the environment (art. 26 (g)).

¹ The views expressed here are those of the author and do not necessarily reflect those of both the European Environment Agency and the Italian Ministry of Environment.

The significance of these provisions needs to be deepened. As for the cost-benefit analysis, economic and financial aspects stand out; some elements are further requested to be explained in the case of investment in infrastructure, such as an indication of the anticipated rate of use and the application of Community rules on public contracting, and in the case of investment in production facilities, such as the analysis of the market prospects in the sector concerned and the anticipated return on the project. In both cases no indication is stated in terms of environmental impact. Nevertheless environmental components are a typical feature of a traditional cost-benefit analysis and should be naturally considered.

As for the evaluation of the environmental impact, this seems to be a report/analysis that goes further the Community EIA (Environmental Impact Assessment) procedure: projects funded under Community Structural Funds with a total cost over € 50 million require such evaluation, may these be normally subject to EIA or not.

The new proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund for the **next programming period 2007-2013**², recalls the definition of *major projects* as well as the provision of both a cost-benefit analysis and an analysis of the environmental impact: furthermore it adds a financial distinction in terms of issues covered by the project, i.e. *major projects* are those whose total cost exceeds €25 million in the case of the environment and €50 million as for other fields.

This reminds the approach adopted for the **1994-1999 programming period**, where the threshold to classify a project as *major* was €25 million, never minding the concerned field. In 1997 the European Commission provided guidelines to cost-benefit analysis of *major projects*, due to the incomplete and not-exhaustive analyses experienced in the case of 1994-1999 projects³ As a compromise for the strengthened commitment in terms of cost-benefit analysis, based on a Member Countries' proposal, the threshold for a project to be classified as *major* in the frame 2000-2006 was increased to €50 million.

The proposal for next programming period 2007-2013 seems to take origin from a pragmatic consideration: projects for environment over the threshold of €50 million are few; most are in the transport field. This is a typical scenario of countries experiencing **Objective 1 or 2**, for the related Operational Programmes generally have a wide fragmentation under the €50 million threshold. The main reason for the proposed distinction seems to aim to guarantee that analyses are made for a "reasonable" number of environmental investments and a similar reasonable number in the transport field: otherwise a unique threshold at €25 million would experience a great number of the latter under commitment. "Reasonable" being a concept apparently related to the Commission capacity of supervision and to Member Countries capacity of analysis; may be also to the political acceptability.

The proposal is still under discussion and it may be convenient to eliminate the distinction among major projects made on the basis of the covered field: this seems to be a focal point, due to the fact that the environmental impact of a project concerning energy or

² Presented by the European Commission in July 2004 (COM(2004)492).

³ European Commission., *Guide to Cost Benefit Analysis of Major Projects*, DG Regional Policy, 1997 (Florio M. ed.). Two years ago a more advanced version has been issued: European Commission, *Guide to cost-benefit analysis of investment projects*, DG Regional Policy - European Commission , 2002 (Florio M. ed.).

transport or industry infrastructures needs to be well assessed, at least as the impact of direct “environment” investments. It seems reasonable to base priority in assessment more on the importance of resources devoted to projects (over e.g. €25 million threshold) than to an equity principle among sectors (environment vs non-environment, i.e. mainly transport).

Moreover, this may be the occasion for better defining the role of the cost-benefit analysis as for the environmental view, or at least to describe a clear relationship between CBA and the commitment for the evaluation of the environmental impact.

In the current programming period (2000-2006), only a few regions in the Italian Mezzogiorno area (i.e. 7 Obj.1 Regions of the South) have experienced EU major projects: moreover, problems have been encountered as for the cost-benefit analysis, that has scarcely experienced the involvement of the local Environmental Authorities. The state-of-the-art as of September 2004 is summarised in Box 1.

Box 1: The cost-benefit analysis under Community Structural Funds in the Objective 1 Regions ⁴

Molise and Basilicata

There are no major projects.

Campania

There are five major projects in the transport sector. The Environmental Authority has been particularly involved in the Environmental Impact Assessment, but not in the CBA commitment. The European Commission required further details as for the CBAs presented: the Regional Managing Authority is currently organising an external technical support to re-elaborate the analyses.

Sardegna

There are only two projects classified as major, regarding the transport sector. For both the CBA has not been prepared yet, due to the dispute on who should carry it on.

Calabria

There is one major project for waste management. The Regional Managing Authority will involve external expertise to elaborate the appraisal documents, including the CBA.

Sicilia

There are six major projects regarding water, transport and urban areas. The CBAs were drafted by both internal and external expertise. The European Commission required for further integration.

Puglia

There are four major projects concerning the industry and transport sectors. The Environmental Authority co-drafted the required evaluation of the environmental impact, but not the CBA. The European Commission required for further integration.

2. Community performance reserve

Each Member State, in close consultation with the European Commission, had to assess under all the three Community Structural Funds Objectives the performance of each of

⁴ Information in the table is under continuous updating.

their Operational Programmes or Single Programming Documents at the end of 2003, following the requirements of Reg. (EC) 1260/99. This activity brought to the allocation of the 4% Community performance reserve (a premium for efficient programmes): a limited number of **criteria to be pursued and related monitoring indicators** were stated by each Member State, under approval of the European Commission, reflecting *effectiveness*, *management* and *financial implementation*, and measuring the mid-term results in relation to their specific initial targets.

As for the Italian context, there were three different work activities for each of the three Objectives, in order to clearly define the opportune **criteria and indicators** in the three fields (*effectiveness*, *management* and *financial implementation*). Eight criteria were defined for Objective 1 (one in the *effectiveness* field, four in the *management* field, two in the *financial implementation* field: six compulsory, at least one in each of the three fields); six for Objective 2 (one each in the *effectiveness* and *financial implementation* fields, both compulsory, and four in the *management* field, three of which compulsory); eight for Objective 3 (three each in the first two fields, two for *financial implementation* one: the minimum compulsory threshold to be satisfied had to be defined on a case-by-case basis).

Relating to the CBA exercise, there is a requirement under the *management* field provided for the Objective 2 area (Centre-North of Italy) that is of interest: the criterion "Quality of the selection criteria" that requires the "*adoption of **selection procedures based on an economic-technical feasibility study or on a CBA, to be applied to infrastructures' projects that on 30 September 2003 present a relevant amount of commitment compared with the total amount of commitments***".

In the details, the requirement for the allocation of the performance reserve is to be retained satisfied when at least 60% of the aforementioned projects had been selected until 30 September 2003 under at least one of the following conditions:

- on the basis of an economic-technical feasibility study, for each project whose total cost exceeds € 5 million;
- on the basis of a CBA, for each project whose total cost is between € 500.000 and € 5 million.

This criterion was chosen by 9 out of 14 Objective 2 Regions in order to gain the performance reserve:

- Lombardia, Piemonte and Toscana: they joined both the conditions;
- Abruzzo, Umbria and Valle d'Aosta: they adopted only the first condition, i.e. an economic-technical feasibility study for each project over € 5 million;
- Bolzano, Emilia-Romagna and Liguria: they adopted only the second condition, i.e. a CBA for each project between € 500.000 and € 5 million.

It has to be noticed that the CBA applied in this context is often made on the basis of a simplified procedure, as in the case of **Toscana Region**, that has experienced more than 300 analyses in the last two years. The Regional Managing and Environmental Authorities strictly collaborate in this process⁵. A support to the CBA process is given by Irpet (Istituto

⁵ Useful documents and reports can be found on the web-site:
http://www.docup.toscana.it/service/analisi_costi_benefici/analisi_costi_benefici_index.htm.

regionale per la programmazione economica della Toscana – Regional Agency for Toscana economic programming).

As for the 7 Objective 1 Regions (**South of Italy**), the requirements stated to obtain the performance reserve (premium) include the criterion "Quality of the selection criteria" analysed in the Objective 2 frame, but with some main differences in the contents:

- first of all, it does not clearly mention any extra CBA exercise (neither does any other criterion): only an economic-technical feasibility study is recalled for those projects that on 30 June 2003 exceed a certain cost depending on the fund they are under (i.e. € 10 million in the case of a project under ERDF, € 5 million under EAGGF and FIGG, € 2,5 million under SFE). The requirement is valid for both National and Regional Operational Programmes;
- second, it mentions an "environmental sustainability criterion" that had to be positively tested for at least 50% of the projects committed until 30 June 2003, in order to contribute to the reserve goal. The criterion covers all interventions funded under the National Operational Programmes "Local development", "Fishery" and "Transport"; in the frame of the Regional Operational Programmes it relates to all projects under the Priority "Local development" as well as transport projects under the Priorities "Cities" and "Networks";
- third, the criterion is expressly classified as not compulsory (whereas it is substantially compulsory for Objective 2 Regions).

The Italian National Environmental Authority was asked to better define the elements for the environmental sustainability requirement. Elements were given through methodological documents⁶. Data about the adoption and the consequent outcomes of the related criterion in order to obtain the Community performance reserve are not available yet.

3. The role of the European Investment Bank

The current Community Structural Funds frame states the possibility for the European Investment Bank (EIB) and the European Investment Fund (EIF) to participate, in accordance with the modalities laid down in their statutes, in the programming of assistance from the Funds. The statement is recalled in the proposal for the next programming period 2007-2013. Both Community programmes and projects can be co-funded: the EIB usually funds the regional/local component.

In the framework of the Community cohesion policy, EIB has built an appraisal procedure that is reserved to co-financed interventions. Two different appraisal procedures are distinguished, whether the project is classified as a EIB *major project* or not (i.e. over € 25 million): in the first case a set of analyses in terms of economic-financial impact - which can be substantially considered equivalent to a CBA - is provided with the aim to verify the effectiveness and efficiency of the project, and this procedure explicitly includes a practice for the valuation of its environmental sustainability.

As for projects whose total cost is under € 25 million, EIB makes a simpler analysis and the basis are essentially two: all documents prepared for the European Commission (e.g.

⁶ E.g. Rete Nazionale delle Autorità Ambientali e di Programmazione, "Indirizzi tecnici e metodologici per la valutazione dei programmi operativi", Ministero dell'Ambiente (2002)

ex-ante environmental impact, up-dated information on the transposition of EU environmental legislation into domestic legislation) and a visit on site including a discussion with the region's environmental unit(s), covering organisational aspects and devoted resources. The focus for the EIB is EIA and Natural Reserve Areas.

It has to be remarked that the EIB appraisal procedure in both cases is destined to interventions co-financed by EIB: however the appraisal adopted for EIB *major projects* (over € 25 million) can be applied to what EU calls *major projects* (i.e. those over € 50 million) funded under European Regional Development Fund: it happens when the European Commission requests EIB to make a CBA for EU major projects, even if they are not co-financed by the EIB.

The Bank also experiences co-funding of programmes, with a consequent allocation of money among the related interventions: in this case, projects under the co-funded programme that finally present a total cost over €25 million are few or may not be present. The aforementioned scenario of countries experiencing Objective 1 or 2 in terms of fragmented allocation of funds among all interventions is still valid under the €25 million threshold. The Italian Objective 1 Regions correspond to this frame: in fact the EIB exercise for the appraisal of the environmental sustainability of co-funded projects in the Mezzogiorno area seems to be missing or scarcely relevant.

The EIB appraisal for *major projects* is a practice more likely applied in countries benefiting from the Cohesion Fund, whose regulations state the same possibility of participation by EIB: this is due to the fact that the Cohesion Fund operates on a project rather than on a programme basis, so that projects with a total cost exceeding € 25 million are more frequent.

Conclusions/main remarks

The EIB practice to assess environmental sustainability of a project may be taken into consideration as a best practice: Community Structural Funds regulations should include a clear and explicit provision of a **“chapter” in the cost-benefit analysis to be dedicated to environmental sustainability aspects**; otherwise, the same result may be achieved by stating a clear and explicit link between the two already provided documents for the cost-benefit analysis and for the appraisal of the environmental impact of the intervention.

In order to make the exercise of cost-benefit analysis more effective within Structural Funds (Cohesion Policy) and to let the environmental dimension be more and more integrated in the procedure, two conditions should be satisfied:

- to **broaden the class that requires a cost-benefit analysis** (e.g. major projects are all those whose total cost exceeds €25 million, not only the environmental ones, also in order to be consistent with EIB activity);
- to **involve Environmental Authorities** in the cost-benefit analysis.

For the sake of **sustainable development**, economic driven instruments should always include environmental concerns as well as environment driven instruments should systematically include economical issues.