Consistency of financial flows with the Paris Agreement objectives – the EU navigating the transition towards climate neutrality and resilience

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1. INTRODUCTION

With the Paris Agreement, the world made an unprecedented commitment to hold global temperature rise to less than 2 °C above preindustrial levels and to pursue efforts to limit it to 1.5 °C. However, the world is not on track, and the scale and severity of climate change impacts are a stark reminder of the urgency of action. Key ingredients for success include political ambition and commitment, translated into a clear implementation framework to guide, amongst others, financial and economic decisions. In this context, finance plays a crucial role in achieving climate objectives by integrating climate aspects into financial choices and financing mitigation and adaptation solutions for a just transition that leaves no one behind.

This is at the heart of the Paris Agreement: **making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development** is one of its objectives[1], as achieving the Agreement's temperature and resilience goals is not possible without aligning finance, both in the real economy and in the financial system[2].

This Staff Working Document provides an overview of the current international context, and **the policies and measures already in place in the EU to make finance flows consistent with the Paris Agreement**. In doing so, it demonstrates the EU's commitment to fully implementing the Paris Agreement, including Article 2.1c. It highlights the challenges and opportunities faced by EU governments, businesses and financial institutions, and lays the **foundation for a political reflection on how this critical effort could be further strengthened, both in the EU and globally.**

This endeavour is recognised as a key driver for mobilising climate finance to the extent necessary to transform the economy and achieve mitigation and adaptation objectives. This requires not only increasing climate finance, but also shifting capital away from harmful activities, and above all reducing funding for fossil fuels. It is not only the size of capital reallocation needed to achieve the Paris Agreement goals that matters. It is above all a change in mindset that is needed, to reform the processes and rules governing financial decisions.

The broader effort requested by Article 2.1c would have a deeply transformational impact, calling for a reform of the economy that places consistency with the Paris Agreement goals at its core. This effort starts with

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[1] Article 2.1 of the Paris Agreement indicates as objectives: (1) to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5°C (article 2.1a), (2) to promote climate resilience development (article 2.1b),(3) Article 2.1c https://unfccc.int/sites/default/files/english_paris_agreement.pdf.

[2] Intergovernmental Panel on Climate Change (IPCC), *Climate Change Synthesis Report*; page 1553., 2023. https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf.

domestic policies, that each country can decide to adopt to achieve these goals, making it a global effort.

Over the last few years, **the European Union (EU) has made significant strides towards enhancing the consistency of finance flows with the goals of the Paris Agreement at all levels**. In line with Article 2.1c, e EU has integrated climate change into the heart of its economic, social and development practices through various domestic and international initiatives.

These actions signal a proactive stance to deliver EU climate targets and contribute to the global effort to combat climate change. As part of a global effort, the EU has taken the lead in mobilising climate finance domestically and internationally from a wide variety of sources, instruments and channels (including instruments to unlock the huge potential of private finance through the targeted use of public climate finance) and a variety of actions aligning financial flows with the Paris agreement.

2. EU POLICIES AND TOOLS FOR ALIGNING FINANCE FLOWS WITHIN AND OUTSIDE EU

Achieving coherence of finance flows with the Paris Agreement requires a comprehensive approach to economic and financial reforms to scale up investment in mitigation and resilience across the economy, while transitioning away from funding GHG intensive activities, and taking into account equity considerations. This effort encompasses domestic and international finance flows, including public spending and investments, as well as financial institutions, businesses, corporations, and other private actors.

The EU places these aspects at the core of the European Green Deal and has established visions and tools to deliver on it domestically and globally. The following sections provide with an overview of the concrete actions designed and implemented by the EU to make finance flows consistent with the Paris Agreement domestically and globally.

Box 1: Article 2.1 of the Paris Agreement

Article 2.1. This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by:

(a) Holding the increase in the global average temperature to well below 2 °C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 °C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;

(b) Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production; and

c) Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

2.1. Setting the EU context

The **European Green Deal**[3] represents the EU's political strategic vision for a new growth model that aims to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases by 2050 and economic growth is decoupled from resource use. Additionally, it aims to protect, conserve and enhance the EU's natural capital, and protect the health and well-being of citizens from environment-related risks and impacts. The European Green Deal sets the blueprint for transformational change and sends a clear signal, including to investors, on the direction for the next 30 years, fostering sustainable and climate-resilient development.

The **European Climate Law** (Regulation (EU) 2021/1119)[4] enshrines into law the objective for the EU to become climate-neutral at the latest by 2050. Both the EU Institutions and Member States are obligated to take necessary measures to meet this target, while considering fairness and solidarity among Member States. The law also establishes a legally binding target: reducing net greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels.

In November 2021, the Commission updated its **Better Regulation instruments**[5] to ensure that new EU policies align with climate and environmental goals. All proposed EU measures must now be assessed for their consistency with climate objectives as part of the impact assessment process, in accordance with the European Climate Law (the climate-consistency check).

The **Fit for 55 package**[6] revises and updates EU legislation, aligning it with the EU's climate objectives. These objectives include: (i) achieving the binding commitment under the EU Climate Law to reduce net greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels; (ii) ensuring a just and socially fair transition[7]; (iii) maintaining and strengthening innovation and competitiveness of EU industries; (iv) upholding the EU's leadership in the global fight against climate change. Many of the investments required to meet the 2030 climate and energy targets have long-lasting impacts that span over decades.

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[3] EUR-Lex - 52019DC0640 - EN - EUR-Lex (europa.eu).
[4] European Climate Law | EUR-Lex (europa.eu).
[5] https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation_en, 199176cf-6c4e-48ad-a9f7-9c1b31bbbd09_en (europa.eu).
[6] Delivering the European Green Deal - European Commission (europa.eu).
[7] See in particular the Council recommendation on ensuring a fair transition towards climate neutrality, adopted in 2022. https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32022H0627(04).

Figure 1: The Fit for 55 Package

The European Climate Law also outlines a process for setting a Union-wide 2040 climate target. Recently, the EU Communication "**Securing our future - Europe's 2040 climate target** and path to climate neutrality by 2050 building a sustainable, just and prosperous society"[8] recommended a 90% net greenhouse gas emissions reduction by 2040 compared to 1990 levels to set the path to climate neutrality by 2050. Setting a climate target for 2040 now will help EU decision-makers, Member States, and stakeholders to take the necessary decisions in this critical decade, so that these decisions are compatible with the 2040 target and the climate neutrality objective, minimising the risks of lock-in to costly, sub-optimal paths and stranded assets. Defining such a target will further contribute to establishing certainty, which will, in turn, help investors to plan their investments in line with this direction.

The European Climate Law requires the EU to ensure progress on adaptive capacity, strengthening resilience and reducing vulnerability. The **EU Adaptation Strategy**[9] is a crucial pillar of the European Green Deal and aims at enhancing the European Union's resilience to climate change impacts. It focuses on making the EU climate-resilient by 2050 and aims to adapt to the unavoidable impacts of climate change[10]. The strategy underlines the need to

8 EUR-Lex - 52024DC0063 - EN - EUR-Lex (europa.eu)
9 EUR-Lex - 52021DC0082 - EN - EUR-Lex (europa.eu)
10 In November 2022 the European Commission set up the Climate Resilience Dialogue as concrete actions set out in the 2021 EU Adaptation Strategy and in the Strategy for Financing the Transition to a

deploy nature-based solutions to increase climate resilience as a clear example of synergies between climate and biodiversity objectives in EU policies. The Communication "**Managing climate risks - protecting people and prosperity**"[11] sets forth a vision for enhancing societal and economic resilience to changed climatic conditions and has convened a temporary Reflection Group to carry forward work on investments in adaptation and to consider further ways to boost financing towards climate resilience.

Achieving climate neutrality and climate resilience requires substantial amounts of finance. In the EU, it is estimated that an additional 1.5% of GDP compared to the 2011-2020 decade should be invested annually in the transition – moving resources away from less sustainable uses like fossil fuel subsidies.

The recent Communication from the European Commission on Europe's 2040 climate targets estimates that the average annual investment in the energy system, excluding transport, will need to increase to about EUR 660 billion per annum in 2031-2050, from 1.7% of GDP in 2011-2020 to 3.2% in 2031-2050. This should be put into perspective with the value of fossil fuel imports which in 2022 soared to EUR 640 billion (4.1% of GDP), because of Russia's war of aggression against Ukraine. In 2023, when prices came down substantially, net fossil fuel import costs still accounted for about 2.4% of GDP.

According to the "2023 Climate Action Progress report"[12] between 2021 and 2030, additional public and private investment of more than EUR 477 billion per annum are estimated to be needed for achieving our climate and energy targets. Further investments are needed to achieve EU objectives related to building climate resilience, protecting the environment, and reducing non-energy greenhouse gas emissions. About EUR 110 billion will be necessary by 2027 to meet environmental objectives. Meeting these needs requires a mix of policies and instruments to scale up finance and to reorient fossil and environmentally harmful finance towards climate neutral and sustainable resilient development.

Sustainable Economy aimed to address climate protection gaps in the EU. The Dialogue works as a platform that facilitates exchanges among insurers, reinsurers, public authorities, SMEs, consumers and other stakeholders on ways to reduce the protection gap and increase investments in good adaptation solutions. The Dialogue will deliver its final report in summer of 2024. https://climate.ec.europa.eu/eu-action/adaptation-climate-change/climate-resilience-dialogue_en.

[11] EUR-Lex - 52024DC0091 - EN - EUR-Lex (europa.eu).

[12] 60a04592-cf1f-4e31-865b-2b5b51b9d09f_en (europa.eu).

2.2. The EU policy toolkit to making finance flows consistent with Paris agreement goals within the EU

The Fit for 55 legislative package, underpinning the objectives of the European Green Deal and the European Climate Law, strikes a balance between pricing, targets, standards or rules, and support measures.

In addition, efforts to meet the EU's emission reduction targets and climate adaptation objectives are supported by complementary regulations for specific sectors, as well as across sectors. These policies contribute to reducing greenhouse gas emissions and increasing our climate adaptation capacity while complementary policies and tools are needed to redirect the necessary finance into climate neutral and resilient investments. Central to these efforts are the policies and frameworks that foster a circular economy and harness industrial opportunities arising from the green transition – from new markets to breakthrough clean technologies – and shift investment towards clean and resilient investments. Policies aimed at protecting and restoring ecosystems whose services are key for both climate mitigation and adaptation are also part of the effort.

2.2.1. The EU Emission Trading System

A cornerstone of EU climate policy is the EU Emissions Trading System (EU ETS), set up in 2005 as a means for the EU to meet its first legally binding emissions reduction target under the Kyoto Protocol. The EU ETS was the world's first major carbon market and remains the largest in terms of traded volume today. The system is applied in all 27 member states as well as Iceland, Liechtenstein and Norway, covering approximately 40% of total EU greenhouse gas emissions. As part of the Fit for 55 package, the EU ETS was further strengthened to bring it in line with the binding emission reduction targets set in the European Climate Law for 2030 (at least -55% compared to 1990). Notably, it extends the scope covered by the EU ETS to cover and address emissions from fuel combustion in buildings, road transport and additional sectors (as of 2027 through a new ETS called ETS 2) as well as from the maritime sector (as of 2024) and from extra-EU aviation by implementing the CORSIA through EU ETS (intra-EU aviation has been within the scope of EU ETS since 2012), putting the EU in a frontrunner position for establishing similar measures globally[13].

[13] Global measures implementing the International Maritime Organisation (IMO) 2023 Decarbonisation Strategy are currently under negotiation. 2023 IMO Strategy on Reduction of GHG Emissions from Ships.

The majority of EU ETS allowances are purchased in auctions, with most of the revenues flowing back to the Member States. Since 2013, auctions have raised more than EUR 175 billion and supported an emission decrease of around 38% from installations covered by the schemes. Since the latest revision, Member States are obliged to spend all their revenues for a limited number of climate, energy and social purposes set out in the revised EU ETS Directive, which also include international climate finance. A portion of the allowances is auctioned to finance the Innovation Fund, which supports innovative green technologies, and the Modernisation Fund, which supports the modernisation of energy systems in the 13 lower-income Member States. The EU ETS is a concrete example of an effective carbon pricing tool to reorient financial flows toward climate objectives.

Box 2: Carbon Pricing

Introducing a price signal on GHG emissions is recognised as critical to driving investment and behaviour change to lower emissions. In recent years, carbon pricing instruments have been seen not just as a climate policy but also as tools to increase revenues that can be allocated to climate action, promote innovation and contribute to broader sustainability and development goals.

According to the World Bank (2024), in 2023 carbon pricing revenues reached a record USD 104 billion and as of May 2024, there are 110 compliance mechanisms (carbon taxes or emission trading systems) in operation. While initiatives to put a price of carbon have reached a large international coverage (with different levels of pricing and effectiveness) the EU is recognised as a leader in this field thanks to its very effective emission trading system. Carbon pricing represents a key pillar of the EU's climate policy for almost two decades now by incentivising emission reductions, sending a clear signal to markets and generating revenue for green investments.

2.2.2. The EU Carbon Border Adjustment Mechanism

Climate change is a **global problem that needs global solutions**. As the EU raises its own climate ambition under its ETS, and if less stringent climate policies prevail in many non-EU countries, there is a risk that companies based in the EU move carbon-intensive production to region with less stringent climate policies in place. This is defined as "carbon leakage".

The EU's Carbon Border Adjustment Mechanism (CBAM) is the EU's tool to fight carbon leakage, promote decarbonisation and encourage cleaner industrial production by applying **an equivalent price on the greenhouse gases emitted** during the production of carbon-intensive goods imported into the EU, as if those goods were produced in the EU. At its initial phase, CBAM applies to products from six sectors (steel and iron, aluminium, cement, fertilisers, electricity and hydrogen), selected because of their high level of carbon intensity and high risk of carbon leakage. The CBAM complements and

reinforces the EU ETS, as free allowances will be progressively phased out in these in the EU, sectors while the financial adjustment under CBAM will be gradually phased in from 2026 to 2034.

The transitional phase started in October 2023 and will last until the end of 2025. During this period, only data reporting obligations apply, with no financial adjustment due. Importers of CBAM goods need to report quarterly data about the imported CBAM goods. The collected data will inform the Commission review of the instrument and the adoption of the implementing legislation in view of the definitive regime. From 2026 onwards, EU importers of CBAM goods will gradually be subject to financial obligations, with CBAM certificates to be purchased and surrendered based on the embedded emissions of the imported products.

Any carbon price effectively paid in the country of origin of the CBAM products exported to the EU will be deducted from the financial obligation. Thereby, CBAM is incentivising the uptake of carbon pricing in third countries, which will generate new climate finance revenues in line with the Paris Agreement.

2.2.3. The Green Deal Industrial Plan and the Net-Zero Industry Act

The Green Deal Industrial Plan (GDIP) is a major initiative of the European Green Deal aimed at promoting sustainability and economic growth while reducing greenhouse gas emissions. It seeks to create a competitive net-zero industry in Europe, focusing on four key pillars: (i) A predictable and simplified regulatory environment; (ii) Faster access to funding to speed up investment and financing for clean-tech production in Europe; (iii) Enhancing skills; (iv) Ensuring open trade for resilient supply chains.

The **Net-Zero Industry Act (NZIA)**[14] is the first pillar of the GDIP. On 16 March 2023, the Commission proposed the NZIA to ensure a secure and sustainable supply of net-zero technologies including by scaling up the manufacturing capacity of net-zero technologies and enhancing the resilience of their supply chains.

The Act aims to facilitate the rapid roll-out of manufacturing capacities by simplifying and fast-tracking permitting procedures for Net-Zero Strategic projects. It includes rules for public procurement to incentivise the purchase of net-zero technology products, the organisation of government auctions for renewable energy projects, and other types of support to promote the adoption of net-zero technology equipment. The NZIA sets indicative benchmarks for

[14] European Commission, Net-Zero Industry Act. 16 March 2023, https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/green-deal-industrial-plan/net-zero-industry-act_en.

strategic technologies, reinforces the resilience and competitiveness to reach 40% of production required to cover EU's needs by 2030, while also setting specific target for CO_2 carbon capture and storage, with an annual injection capacity of at least 50 million tonnes to be achieved by 2030. It also foresees setting up **Net-Zero Industry Academies,** which will roll out up-skilling and re-skilling programmes in strategic industries for the green and digital transitions.

The EU State aid rules frame the member States' possibilities to subsidise economic activities to tackle market failures, while ensuring undistorted competition and the integrity of the Single market. In January 2022, the Commission adopted the **Guidelines on State Aid for Climate, Environmental Protection and Energy (CEEAG)**[15], governing the support which Member States intend to provide for environmental protection, including climate protection and green energy generation. These guidelines support broad and flexible measures to decarbonise the economy, open to all technologies that can contribute to the European Green Deal, encompassing renewables, energy efficiency, clean mobility, infrastructure, circular economy, pollution reduction, biodiversity protection and restoration as well as measures to ensure energy supply security. They aim to help Member States meet ambitious EU energy and climate targets, at minimal cost to taxpayers and without undue distortions of competition and trade within the Single Market.

The Guidelines also aim to facilitate the participation of renewable energy communities and SMEs, crucial drivers for the green transition. Notably, the revised guidelines aim to:

- Expand and facilitate to a maximum and far above the previously applicable 2014 guidelines those aid measures that are compatible with the 2030 and 2050 emissions reduction targets, for example for renewables;
- Discontinue support for the most polluting fossil fuels, not compatible with the European Green Deal;
- Set conditions for other measures, such as natural gas, to ensure compatibility with the 2030 and 2050 emissions reduction targets, e.g. there is no displacement of cleaner technologies and no lock-in effects.

The **Temporary Crisis and Transition Framework**[16]**,** adopted by the Commission on 9 March 2023, grants Member States temporary flexibility under the **State aid** rules to foster support measures in sectors which are key for transitioning to a net-zero economy, aligning with the Green Deal Industrial

[15] EUR-Lex, *2022 guidelines on State aid for climate, environmental protection and energy,* 2022 2022 guidelines on State aid for climate, environmental protection and energy | EUR-Lex (europa.eu).

[16] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2023.101.01.0003.01.ENG&toc=OJ%3AC%3A2023%3A101%3ATOC

Plan. Under this framework, Member States can provide aid to measures accelerating the rollout of renewable energy, facilitating the decarbonisation of industrial processes, supporting electricity demand reduction and further hastening investments in key sectors for the transition towards a net-zero economy.

The **General Block Exemption Regulation**[17] (GBER) has been recently amended to further facilitate and speed up support for the EU's green and digital transitions. This targeted amendment will make it easier for Member States to grant necessary support for key sectors in line with the Green Deal Industrial Plan.

2.2.4. Other instruments and tools

On the **reform of fossil fuels subsidies**, the Climate Law amends Article 17 of the Governance Regulation, specifying that the Commission shall adopt implementing acts to set out the structure, format, technical details, and methodology for reporting, including on the phasing out of energy subsidies, in particular for fossil fuels.

Article 3(h) of the 8th Environment Action Programme[18] requires, inter alia, 'phasing out environmentally harmful subsidies, in particular fossil fuel subsidies, at Union, national, regional and local level, without delay by (ii) setting a deadline for the phasing out of fossil fuel subsidies consistent with the ambition of limiting global warming to 1,5 °C. According to the European Environment Agency (2023), fossil fuel subsidies remained relatively stable at about EUR 56 billion (2022 prices) over the period 2015-2021, yet increased to EUR 123 billion in 2022 because of Russia's war of aggression against Ukraine and the resulting energy crisis in the EU.

On 14 July 2021, the Commission adopted a proposal for a revision of the **Energy Taxation Directive**[19] (ETD) as part of the Fit for 55 package. One of the objectives is to align the taxation of energy products and electricity with EU energy, environment and climate policies thus contributing to achieving the EU 2030 targets and climate neutrality by 2050in the context of the European Green Deal.

The Fit for 55 package also includes **ReFuelEU Aviation**[20] which sets harmonised binding targets, which will ramp up the supply and uptake of sustainable aviation fuels at EU airports. In parallel, the adoption of FuelEU

[17] OJ L 167/1, 23.06.2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2023.167.01.0001.01.ENG&toc=OJ%3AL%3A2023%3A167%3ATOC.
[18] OJ L 114/22, 06.04.2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022D0591.
[19] Revision of the Energy Taxation Directive - European Commission (europa.eu).
[20] Regulation (EU) 2023/2405 https://op.europa.eu/en/publication-detail/-/publication/23d2f354-778f-11ee-99ba-01aa75ed71a1/language-en.

Maritime[21] will ensure that the greenhouse gas intensity of fuels used in the sector will gradually decrease over time. The revisions of the EU ETS and ETD would further support the development, production and uptake of sustainable fuels in the EU.

Information instruments raise awareness, promote learning, shift behaviour, and stimulate product and business development, including by making climate risks and opportunities clearer. The Revised Construction Products Regulation (CPR)[22], the EU labelling tools and requirements[23,] the reform of the electricity market design[24], the **Empowering Consumers in the Sustainability Transition Directive** and the **Green Claims Directive** are key examples of the tools to guide a behaviour change in the consumers and industry through more transparent information that avoids greenwashing.

In 2023, the Commission introduced, in the context of the review of the **Horizontal Block Exemption Regulations and the Horizontal Guidelines**, a new chapter on sustainability agreements. The new sustainability guidance has specifically been developed to help companies assess whether their agreements with competitors geared at contributing to the green transition are acceptable under competition law.

Free Trade Agreements concluded by the EU with third countries facilitate the establishment of environmental services suppliers (such as suppliers of services relevant for the development of on-shore and off-shore wind power) in the partner countries, thereby contributing to cross-border investment in green economic activities. For instance, the EU-NZ FTA includes a list of environmental services for which both parties have taken liberalisation commitments.

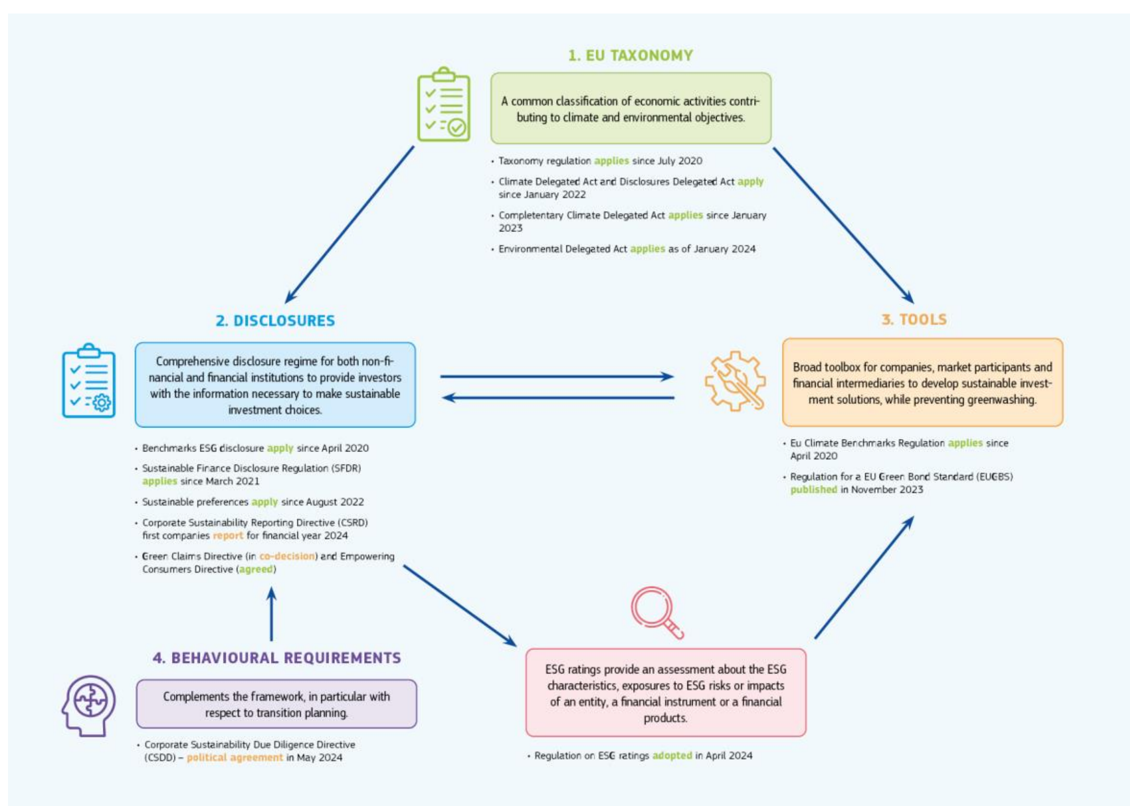
[21] Regulation (EU)2023/1805, https://eur-lex.europa.eu/eli/reg/2023/1805.
[22] Revision of the Construction Products Regulation (europa.eu).
[23] Products - labelling rules and requirements - European Commission (europa.eu).
[30] Electricity market reform - Consilium (europa.eu).

2.2.5. Financial policies and tools

2.2.5.1. The EU Sustainable Finance Framework

The EU's sustainable finance framework aims to enable the alignment of private investments with the objectives of the European Green Deal and the Paris Agreement. Since 2018, the EU has developed the framework based on an EU Taxonomy, disclosures and tools designed to help investors better identify projects that can make a positive environmental impact[25].

Figure 2: The EU Sustainable Finance Framework in a nutshell.



The **EU Taxonomy Regulation**[26] and its delegated acts cover six environmental objectives (including climate change mitigation and adaptation). It establishes a classification system defining criteria for economic activities that are aligned with a net-zero trajectory by 2050, and with broader environmental goals. The EU taxonomy thus helps direct investments to the economic

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[25] The Platform on Sustainable Finance, a Commission expert group, is a key partner in this, bringing together financial and scientific expertise from a wide array of stakeholders from industry, finance, civil society and academia. Platform on Sustainable Finance - European Commission (europa.eu).

[26] Regulation - 2020/852 - EN - taxonomy regulation - EUR-Lex (europa.eu).

activities most needed for the transition. Art. 17 of Regulation (EU) 2020/852[27] introduces the "Do No Significant Harm" (DNSH) principle as an essential concept for private financing within the EU Sustainable Finance framework. The aim of the principle is to ensure that the financed activity will not have a negative impact on the six environmental objectives defined in the Regulation. Beyond private finance, the principle currently applies to some of the major EU funding instruments, including the Recovery and Resilience Facility and Cohesion Policy funds.

Implementing the 'double materiality' principle[28], the **Corporate Sustainability Reporting Directive (CSRD)**[29] and the mandatory **European Sustainability Reporting Standards (ESRS)** are at the core of the EU's sustainable finance framework. Applying as of 2024, they aim to ensure that investors and other stakeholders have access to the information they need to assess the impact of companies on people and the environment, and the financial risks and opportunities arising from climate change and other sustainability issues. At first it will apply to the largest corporates, gradually expanding to cover all large and/or listed companies active in the EU. The framework includes the disclosure of climate transition plans, including companies' alignment with the European Climate Law and Paris Agreement targets. For companies under the same scope as the CSRD, the EU Taxonomy Regulation also requires disclosures on what proportion of their revenues, capital and operational expenditures activities are taxonomy-aligned. Thereby, it also prompts banks and corporates to speed up their transition towards sustainability.

The **Sustainable Finance Disclosure Regulation (SFDR)**[30] provides a framework for how financial market participants and financial advisers have to disclose sustainability information since 2021, such as the potential adverse impacts of their investments. It helps investors interested in financing companies and projects taking into account environmental and social considerations. The Commission is currently carrying out a comprehensive assessment of the framework, looking at issues such as legal certainty, usability and how the Regulation can play its part in tackling greenwashing.

Overall, early signs are encouraging, with many market actors embracing the opportunities offered by the EU's sustainable finance framework. in 2023 and 2024 respectively, non-financial and financial undertakings reported for the first time on their alignment with the EU Taxonomy Climate Delegated Act. Although

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[27] OJ L 198/13, 18.06.2020., https://eur-lex.europa.eu/eli/reg/2020/852/oj.

[28] The 'double materiality' principle is an important concept coined by the EU in its reporting framework. It states that sustainability disclosures should consider both the information on the impacts of companies on the various sustainability factors (inside-out materiality) and the information on the risks that companies face as result of negative changes in these sustainability factors (outside-in materiality).

[29] OJ L 322/15, 16.12.2022, Corporate Sustainability Reporting Directive (CSRD) - 2022/2464/EU, https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.

[30] European Commission, Implementing and delegated acts, - SFDR , Sustainable Finance Disclosures Regulation - European Commission (europa.eu).

implementation is in its early stages, there are indications that the EU Taxonomy is already having an impact on the ground. For example[31]:

- Companies are using the EU Taxonomy and disclosed green revenue and capital expenditure (CapEx) figures showing their efforts towards transitioning of their business models, in particular when they have issued EU green bonds;
- Capital investments into Taxonomy-aligned activities have increased in 2024 compared to the previous year, with the highest investments in the utilities sector, in particular by electricity providers (over 60% Taxonomy-aligned); banks have started incorporating the EU Taxonomy in lending strategies and use it, for instance, to grant green loans or in their assessment of companies' CapEx plans to evaluate their transition readiness. Mortgages and other loans to activities in the scope of the Taxonomy represent, on average, over 50% of the assets of large EU banks;
- 56% of EU funds either promote environmental or social characteristics or have a sustainable investment objective as disclosed according to the Sustainable Finance Disclosure Regulation (SFDR).

To enable tracking progress towards aligning capital flow with the taxonomy, the **Platform on Sustainable Finance**[32] has developed a methodology to monitor financial flows into sustainable investments, examining trends, between financial and non-financial companies, and conducting and publishing a first analysis based on this methodology and available data.

This work is an important step towards understanding the flow of finance towards sustainable investments and as part of this, to consider how these flows compare with the existing Commission estimations regarding the contribution of private financing needed to close the investment gap.

The value of sustainable investments has dramatically increased since the launch of the Sustainable Finance Framework. Absolute figures are already significant. In 2023 for instance, around 600 European companies reported capital investments into Taxonomy-aligned activities of EUR 191 billion. Even more encouragingly, in the first four months of 2024, companies already reported EUR 249 billion, signalling significant growth. ([33])

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[31] Bloomberg reports that as of 17 May 2023, 63% of the STOXX Europe 600 undertakings have already disclosed their taxonomy eligibility and alignment. Moreover, on average the taxonomy alignment of companies in Eurostoxx 600 (those that reported a nonzero value) is around 23% for capital expenditure, 24% for operational expenditure and 17% for revenues. For more detail, please see the European Commission, Platform on Sustainable Finance's Compendium of Market Practices - https://finance.ec.europa.eu/publications/platform-sustainable-finance-report-compendium-market-practices_en.

[32] European Commssion, Platform on Sustainable Finance, https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance/platform-sustainable-finance_en.

[33] European Commission, *The EU Taxonomy's uptake on the ground*, 06.2024 Factsheet: The EU Taxonomy's uptake on the ground (europa.eu).

2.2.5.2. Other Sustainable Finance tools

Additional tools have been established to support investors and investees.

The **European Green Bond Standard** and the **Regulation on ESG Ratings** aim at combating greenwashing and fostering investor confidence through increased transparency. The European Green Bond Standard requires issuers to demonstrate that proceeds from their "green" bonds predominantly go to Taxonomy-aligned activities. For instance, in 2023, 90% of green bonds issued by EU public actors referenced the EU Taxonomy to illustrate their commitment of using the raised funds for green projects. The Regulation on ESG Ratings, approved by the Parliament in April 2024, will require agencies that rate companies against sustainability criteria to be more transparent about their methodologies and eliminate potential conflicts of interests.

In 2019, the **EU Climate Benchmarks** were introduced, enabling the issuance of passive investment funds that meet strict decarbonisation criteria. The Paris Aligned Benchmarks and Climate Transition Benchmarks have been recognised by major investment institutions as solid tools to help investors tailor their portfolios to a decarbonisation pathway. Assets under management of financial products referencing the benchmarks reached an estimated EUR 116 billion in 2023.[34] This has since grown to EUR 180 billion and is expected to surpass the EUR 200 billion mark in due course.

Finally, in the summer of 2023, the Commission issued a Recommendation to help directing transition finance towards companies at varying sustainability stages[35] . The Recommendation explains how companies, banks, investors, and financial intermediaries can voluntarily use the taxonomy and other sustainable finance instruments to facilitate this transition.

2.2.5.3. Integration of climate risks into financial policies

Financial supervisors and regulators in Europe and elsewhere are increasingly aware that climate change also represents a financial risk. The new prudential requirements coming into force in 2025, through the reviews of the Capital Requirements Regulation (CRR3) and Directive (CRD6), will **require banks to systematically identify, disclose and manage sustainability risks** (environmental, social and governance or ESG risks) as part of their risk management. **Supervisory authorities will assess climate-related financial risks** (both physical risk and transition risk) that banks may meet, and their related management over the short, medium and long term.

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[34] European Commission, *Questions and Answers on the Sustainable Finance package,* 13.06.2023, Questions and Answers on the Sustainable Finance package (europa.eu).

[35] European Commission, General publications: *Sustainable finance package*, 13.06.2023, Sustainable finance package 2023 - European Commission (europa.eu).

This will improve the understanding of the risks and enable competent authorities to address financial stability concerns that could arise from material exposures and banks' mispricing of ESG risks on their balance sheet, including those arising from climate transition on their investment's portfolio. Banks will have to draw concrete plans to address the risks and carry out stress-test for resilience and long-term negative impacts to climate-related financial risks. With the recognition of ESG-related risks and the incorporation of ESG elements in the prudential framework, this initiative complements the EU broader strategy for a more sustainable and resilient financial system.

The Commission has also invited the European Supervisory Authorities (ESAs), the European Central Bank (ECB) and the European Systemic Risk Board (ESRB) to cooperate in a one-off exercise that should **assess the financial system's resilience during the transition to the EU's climate targets for 2030**. This one-off exercise will provide a better understanding of the possible vulnerabilities in the financial system. The European Central Bank and the European Banking Authority also take climate risk into account when performing their duties and expect banks to reflect such risks in their risk modelling. They play a pivotal role in the international collective initiative Network for Greening the Financial System (NGFS), which considers both climate change and biodiversity loss as risks to the financial stability.

2.2.5.4. Reducing the climate insurance protection gap

Insurance is a key financial risk management tool that helps mitigate the economic and financial consequences of climate change-related events, particularly with regards to disasters, and can help reduce societies' vulnerability and increase overall societal resilience. Only around 19.5% of economic losses from extreme weather and climate-related events in Europe were covered by insurance during the period 1980-2024 with large disparities across countries[36]. The expected increase in severity, frequency and duration of disasters could **widen this insurance protection gap in the medium to long term** and challenge the availability and affordability of insurance cover.

As part of the efforts to implement the European Green Deal in the insurance sector, Level 2 rules under both Solvency II[37] and the Insurance Distribution Directive were amended in 2021 to streamline sustainability risks into the prudential and business conduct framework of insurers and insurance distributors[38]. In November 2022, the European Commission set up the **Climate**

[36] European Environment, *Agency, European Climate Risk Assessment,* EEA Report No 1/2024, 01.2024, https://www.eea.europa.eu/publications/european-climate-risk-assessment.

[37] European Insurance and Occupational Pensions Authority, Solvency II, 2016, Solvency II - European Union (europa.eu).

[38] In addition, the new rules agreed in the context of the recent review of the Solvency II Directive will further strengthen the supervision and management of sustainability risks, as well as the disclosure of sustainability information. Insurers will be required to develop specific plans to address financial risks

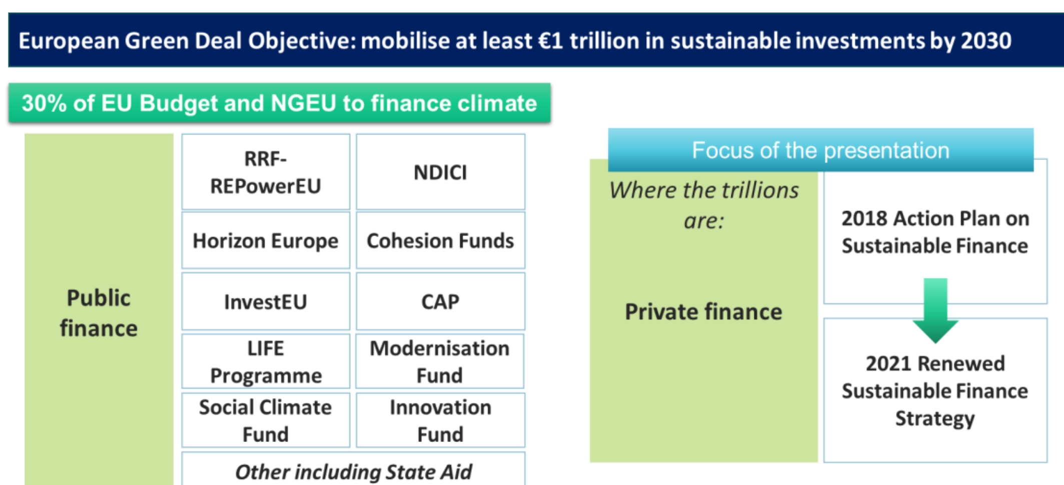
Resilience Dialogue to address the climate protection gap in the EU, in line with the 2021 EU Adaptation Strategy and the Strategy for Financing the Transition to a Sustainable Economy. The Dialogue provides a platform for exchanges among insurers, reinsurers, public authorities, SMEs, consumers and other stakeholders on ways to reduce the protection gap and increase investments in good adaptation solutions. It will deliver its final report in summer of 2024.

stemming from sustainability factors, conduct long-term scenario analyses if materially exposed to climate change risks, disclose information related to sustainability risks in their Solvency and Financial Condition Report and consider both sustainability risks and impacts on sustainability factors in their investment strategy, among other aspects. From 2024 onwards, insurers will be required to regularly report to supervisors physical and transition risk metrics on investments, as well as information on the location of property investments and more granular information on the sectors in which the (re)insurers invest.

2.3. Aligning EU funding instruments with the goals of the Paris Agreement

The EU has taken significant steps to ensure the EU budget contributes to climate action, both directly – by setting a minimum spending target across its financing instruments – and indirectly, by promoting the mainstreaming of climate consideration across the board. Figure 3 summarises the main instruments that support climate action in the EU and internationally.

*Figure 3: Overview of EU funding instruments**



**Important to note that funding from the EU ETS revenues is a so-called externally assigned revenue (in the sense of the Financial Regulation) that does not fall under the EU budget.*

2.3.1. Funding from the EU Emission Trading System

Since the last revision of the EU ETS Directive (see Section **Error! Reference source not found.**), a part of the revenues is dedicated to funding strategic priorities in the transition.

The **Innovation Fund**[39] is one of the world's largest funding programmes for the demonstration of low- and zero-carbon innovative solutions and technologies in the areas of energy, energy intensive industry, mobility and buildings, funded entirely from the EU ETS and estimated at EUR 40 billion until 2030[40]. 442 million tonnes of carbon dioxide reduction are expected from the

[39] For more information: https://climate.ec.europa.eu/eu-action/eu-funding-climate-action/innovation-fund_en.

[40] Estimates based on approximately 530 million allowances that have been reached and assuming an average auctioning price of EUR 75 per tonne of CO_2.

Innovation Fund over the first 10 years of operations[41]. The Fund has so far provided grants for projects through calls for proposals and project development assistance. Since 2023, the Fund can also provide grants through competitive bidding (auctions).

With 100 projects under implementation in May 2024, the Fund has committed around EUR 6.5 billion so far. Additionally, around EUR 5 billion[42] are reserved to be committed by end 2024/early 2025[43] or have already been selected and are under grant preparation following the auction for renewable hydrogen[44]. 442 million tonnes of carbon dioxide reduction are expected from the Innovation Fund over the first 10 years of operations[45].

The **Modernisation Fund**[46] supports the thirteen lower-income Member States in meeting 2030 climate and energy targets by modernising energy systems and improving energy efficiency. In addition to the revenues from the auctioning 2% of the total EU ETS allowances between 2021 and 2030 (increasing to 2.5% between 2024 and 2030), six beneficiary Member States have decided to transfer additional allowances to the Fund, bringing the total number of allocated allowances to 757 million – expected to generate a total of EUR 56.8 billion over 2021-2030.

The **Social Climate Fund**[47] (SCF) is created to ensure that the green transition is fair and leaves no one behind. It will operate from 2026 until 2032 to address the social impacts arising from ETS 2 on vulnerable groups in the EU– including households and vulnerable micro-enterprises – though temporary direct income support and through dedicated measures and investments in buildings, energy and transport. Together with a mandatory 25% contribution of the Member States to their Social Climate Plans, the SCF is expected to mobilise at least EUR 86.7 billion.

The Strategic Technologies for Europe Platform (STEP) Regulation aims to reorient funding from 11 existing EU programmes towards the development and manufacturing of clean and resource efficient technologies that are critical to ensure that the EU can reliably pursue its green transition goals.

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[41] Annexes to the report from the Commission to the European Parliament, the Council and the Court of Auditors. Annual Performance Report for the EU Budget ‘2023 financial year COM(2024) 401 final.

[42] This includes a call of EUR 4 billion and the auction of EUR 0.7 billion awarded.

[43] European Commission, *Innovation Fund: Overwhelming response to the 2023 net-zero technologies call*, Innovation Fund: Overwhelming response to the 2023 net-zero technologies call - European Commission (europa.eu).

[44] European Commission, Press release: *European Hydrogen Bank auction provides €720 million for renewable hydrogen production in Europe,* 30 April 2024, European Hydrogen Bank auction provides €720 million (europa.eu).

[45] European Commission, COM(2023) 401 final, ANNEXES 5 to 11ANNEXES to the REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COURT OF AUDITORS Annual Management and Performance Report for the EU Budget - Financial Year 2022, 20.06.2023, COM_COM(2023)0401(ANN03)_EN.pdf (europa.eu).

[46] For more information: https://modernisationfund.eu/.

[47] For more information: https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/social-climate-fund_en.

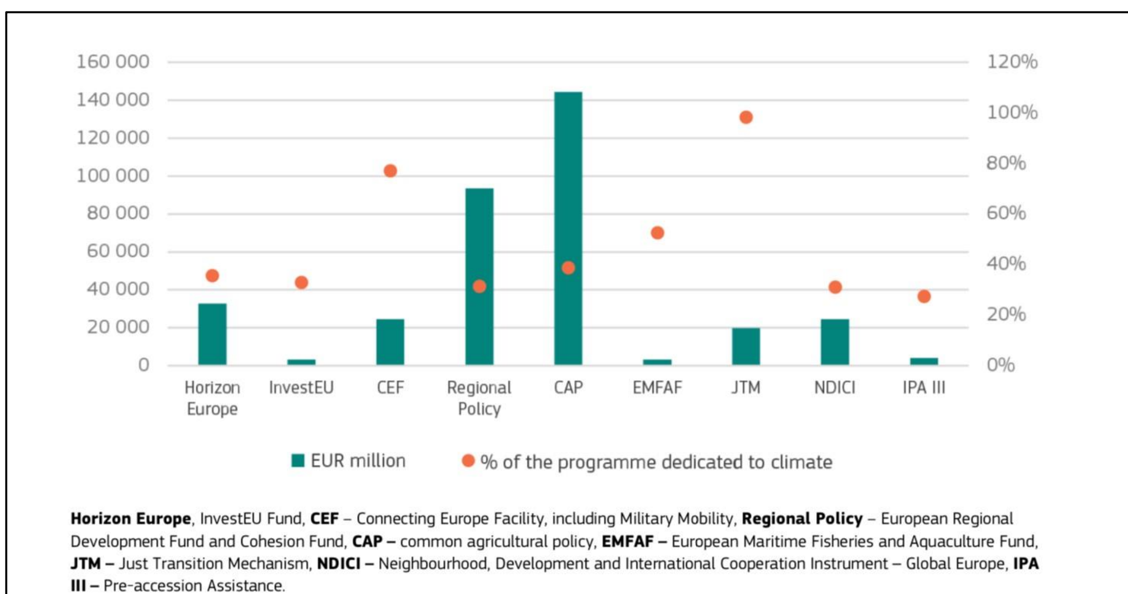
2.3.2. Climate expenditure in the EU budget – domestic dimension

At EU level, investment for the green transition flows from two main sources: the EU **Multiannual Financial Framework** (MFF) for 2021-2027 and the **'NextGenerationEU'**[48] (NGEU) instrument – the centrepiece of which is the EU's '**Recovery and Resilience Facility** (RRF)'[49] – that supports the EU's recovery from the economic downturn induced by Covid-19.

To help achieve climate goals set out in the European Climate Law and the European Green Deal, the EU has decided to integrate (or 'mainstream') climate action across the entire EU budget. According to Annual Management and Performance Report for the EU Budget - 2023 financial year (COM/2024/401 final) published on 19 June 2024, **the EU budget – including NextGenerationEU – is projected to contribute EUR 658 billion to climate spending, representing 34.3% of the budget envelope**. Furthermore, the "do no harm" principle is applied across the different instruments even though the principle is operationalised in different ways. An amendment of the Financial Regulation has been agreed for the next MFF to further integrate the principle.

48 For more information: https://next-generation-eu.europa.eu/index_en.
49 For more information: https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility_en.

Figure 4: Planned Expenditure in the 2021-2027 EU budget in absolute amounts and estimated percentage of each programme envelope



Source: Annexes to the report from the Commission to the European Parliament, the Council and the Court of Auditors. Annual Performance Report for the EU Budget 2023 financial year COM(2024) 401 final

2.3.2.1. The Recovery and Resilience Facility

The EU's Recovery and Resilience Facility (RRF) is the EU's recovery instrument – with a value of up to EUR 723.8 billion – which **enables Member States to make their economies and societies more sustainable, resilient and prepared for the green and digital transitions**.

To qualify for the Facility's grants (EUR 338 billion) and loans (EUR 385.8 billion), Member States have prepared recovery and resilience plans (RRPs) setting out investments and policy reforms to address the challenges identified in country-specific recommendations under the European Semester framework of economic and social policy coordination. The rules governing the RRF provide with a strong focus on accelerating the transition towards a net-zero and green economy. Each national plan must allocate a minimum of 37% of its total financial envelope to climate action (including to promote energy efficiency and renewable energy across the economy): this target has been exceeded, with the estimated climate expenditure of the 27 national plans standing at around 42%.

In addition, following adoption of the REPowerEU Regulation at the end of 2022, 23 **Member States have complemented their RRPs by 2023 with 'REPowerEU chapters'**, to provide a joint response to the energy crisis caused by Russia's invasion of Ukraine. The new or scaled-up investments and reforms

will enable Member States to step up efforts to end dependence on Russian fossil fuels and to accelerate the clean energy transition to secure more affordable, resilient and sustainable energy supply.

Box 3: Green Budget

Greening national budgets is key for climate action and the green transition because budgets are one of the main expressions of how a government intends to implement its political ambition. **The 2019 European Commission's Green Deal Communication** highlights that "*a greater use of green budgeting tools will help to redirect public investment, consumption and taxation to green priorities and away from harmful subsidies".* However, green budgeting requires introducing new methodologies and procedures as well as novel expertise within the national budgetary process.

The European Commission, jointly with the EU Member States, has developed an EU Green Budgeting Reference Framework (GBRF) as a toolkit for Member States willing to implementing or upgrade green budgeting practices and adopts every year a Green Budget annex in the Annual Management Performance Report.

2.3.2.2. The EU's Cohesion Policy

The EU's Cohesion Policy (CP) represents one third of the EU budget (EUR 392 billion) and provides a fundamental stream on structural investments, of which around EUR 93.5 billion will be spent on climate change measures (both mitigation and adaptation). As a result of these investments, more than 25 million tonnes of GHG emissions per year will be reduced in the EU by 2030. Furthermore, Cohesion Policy investments will protect 86 million hectares against wildfires and over 110 million people from climate-related disasters. They will also contribute to the energy and circular economy transitions and to transport decarbonisation.

As part of the EU's cohesion policy, the **European Social Fund (ESF+)** is the main EU funding instrument that invests in people, and it has a key role to play in ensuring that the transition to climate neutrality is fair. It supports the Member States to achieve high employment levels, fair social protection and a resilient workforce ready for the future world of work, as well as inclusive and cohesive societies. Around 5 % of the ESF+ envelope supports climate change objectives by promoting green skills jobs and contributing to the green economy.

The **Just Transition Fund (JTF**) aims to ensure that the transition towards a climate-neutral economy happens in a fair way, leaving no one behind, alleviating the socio-economic impacts of the transition and supporting economic diversification and reconversion of the territories, industries and

workers most impacted. Under this funding mechanism, the Commission, by the end of 2023, adopted programmes by Member States in support through 70 Territorial Just Transition Plans, totalling EUR 19.7 billion[50].

2.3.2.3. LIFE Programme

The Programme for Environment and Climate Action (LIFE) is the EU's funding instrument dedicated to supporting the implementation of environmental and climate legislation and policy priorities.

The LIFE Regulation (EU) 2021/783 introduced a series of novelties in the Programme, including a 61% target for expenditures – or around EUR 3 billion - supporting climate objectives, strengthened actions on energy efficiency and renewable energies with the integration of the new subprogramme "Clean Energy Transition", an increased focus on synergies with other Union funding programmes, in particular Horizon Europe and the Innovation Fund, and an expanded geographical scope involving Overseas Countries and Territories.

2.3.2.4. The InvestEU Programme

The InvestEU programme brings together several EU financial instruments, making access to finance and investments in European companies and projects simpler, more efficient and more flexible. The InvestEU Programme provides the European Union with crucial long-term funding by leveraging private and public funds in support of Europe's sustainable recovery.

The **InvestEU programme has an overall climate target of 30%** (applicable to both the InvestEU Fund and the InvestEU Advisory Fund). Moreover, 60% of the investments supported under the "Sustainable Infrastructure Window" of the InvestEU Fund shall contribute to EU's climate and environmental objectives. The InvestEU budgetary guarantee (EUR 26.2 billion) is expected to mobilise more than EUR 110 billion of green investment building on Union budgetary alongside EIB Group and other implementing partners' resources.

2.3.2.5. Horizon Europe

Horizon Europe is the **9th EU Framework Programme (FP 9) for Research & Innovation (R&I)** that runs from 2021-2027 with a total budget of EUR 95.5 billion - the largest public R&I budget in the world. At least 35% of Horizon Europe's budget will be devoted specifically to climate relevant projects and

50 Annexes to the report from the Commission to the European Parliament, the Council and the Court of Auditors. Annual Performance Report for the EU Budget ' 2023 financial year COM(2024) 401 final.

actions. This includes a strong focus on the areas of climate mitigation and adaptation, as well climate science.

Horizon Europe is also co-funding, with the Innovation Fund and InvestEU, the first large scale collaboration with the private sector, underpinned by matching philanthropic and commercial funds of Breakthrough Energy. This public-private partnership, called the Catalyst, invests in demonstration and early deployment projects with high potential for impact in reducing emissions and progress climate ambition. Moreover, several European Partnership set up under Horizon Europe with the private sector aim to accelerate development of clean zero emission technologies, such as for Clean Aviation and Clean Hydrogen.

2.3.2.6. The Technical Support Instrument (TSI)

Through the Technical Support Instrument, the Commission provides support to Member States in designing, developing and implementing reforms. This tailor-made expertise is provided upon Member State's request and covers a wide range of policy areas including technical support to address environmental and energy related challenges, to enable finance flows consistent with low greenhouse gas emissions and to stimulate climate-resilient growth in line with EU priorities such as the green and digital transitions.

The technical support can include strengthening administrative capacity, harmonising legislative frameworks and sharing good practices. It can also address improving green public financial management practices, such as green budgeting, integrating the "Do No Significant Harm" (DNSH) principle in public investments, green public procurement, biodiversity funding and environmental, health and safety (EHS) matters. Additionally, it can involve macro- and microeconomic modelling of green policies and investments as well as green taxation.

2.3.2.7. The Connecting Europe Facility (CEF)

The Connecting Europe Facility (CEF) is a core EU funding instrument instituted to support strategic cross-border transport and energy projects and thereby facilitate the implementation of the Trans-European Networks for Energy (TEN-E) and Trans-European Networks for Transport (TEN-T) policy. This program supports European climate objectives and the transition towards clean energy sources by strategically allocating funds to critical cross-border energy infrastructure and renewable energy generation projects initiatives. For the 2021-2027 period, **the energy budget of EUR 5.84 billion should help the transition towards clean energy and complete the Energy Union**, making the EU energy systems more interconnected, smarter and digitalised. Nearly 80% of the funding allocated so far under the CEF Transport programme supports the EU's climate objectives; in particular, the EUR 2.3 billion of the

CEF grant budget set aside for the Alternative Fuels Infrastructure Facility (AFIF) supports the rollout of infrastructure for alternative fuels and zero-emission vehicles.

2.3.2.8. Other EU Funding instruments

Around EUR 146 billion, or 39% of the budget of the **Common Agriculture Policy** (CAP) is foreseen to contribute to EU goals on climate action, including climate measures under rural development and the new eco-schemes, bringing CAP climate ambition beyond the baseline requirements. A first overview of the approved CAP Strategic Plans shows that more than 35% of the Utilised Agricultural Area is planned to receive support (i.e. beyond the conditionality) to reduce emissions or store carbon in soils and biomass.

The **European Maritime, Fisheries and Aquaculture Fund** (EMFAF) is the funding instrument of the period 2021-2027 attached to the Common Fisheries Policy (CFP). It supports the fisheries and aquaculture sector in the transition towards climate resilience. Around 53% of EMFAF budget – or EUR 3.1 billion – will be dedicated to climate mainstreaming objectives.

Box 4: Monitoring climate finance consistency

Monitoring policies requires high quality data. Official statistics exist for the EU and the Member States about the following climate financing-related topics such as: (i) CO_2 taxes and other environmental taxes (energy, transport, pollution, natural resources). Eurostat also collects and publishes data on these tax revenues broken down by economic activity for producer units, households and non-residents (tax payers); (ii) environmental protection investments, consumption and other expenses; (iii) carbon, material and energy footprints.

The following new European statistics will become available in 2026:

- Investments on climate change mitigation. These data will provide breakdowns by Member States, cover all sectors of the economy relevant for climate change mitigation, renewal energy, energy efficiency, fuel switch and public transport, carbon capture, storage and destruction and GHG removal by sinks.
- Environmental subsidies and current and capital transfers, according to the European system of accounts (ESA). These transactions are classified by (a) the economic actors who receive the subsidy, such as corporations, households or a foreign economic unit (for example in case of foreign aid). Whenever the recipient of the subsidy is a corporation, they are also classified by economic activity; (b) by environmental purpose. This allows estimates of subsidies for example for climate change mitigation or biodiversity.

Those statistics are produced by the Member States according to the international statistical standard System of Environmental-Economic Accounting (SEEA). Taxes, subsidies, investments, etc. are defined in the same way as in National Accounts so that the data are compatible. These statistics are produced in collaboration with national authorities of the Member States and reported to the Commission (Eurostat) as established in Regulation (EU) 691/2011.

2.3.3. Climate expenditure in the EU budget – external dimension

The EU and its 27 Member States are the largest contributors to international public climate finance, with about EUR 28.5 billion, equivalent to USD 30 billion in 2022.

The European institutions contributed with EUR 6.55 billion to the EU's overall amount of international climate finance in 2022, with EUR 4.03 billion bilateral public finance (all grants) committed by the European Commission, and with EUR 2.52 billion multilateral finance disbursed by the European Investment Bank. 30% of the European Commission public finance in 2022 has been directed to adaptation, 28% targeted mitigation measures, with the rest being cross-cutting finance, with dual benefits for adaptation and mitigation alike.

2.3.4. The NDICI – Global Europe and IPA

The external financing instruments – the **Neighbourhood, Development and International Cooperation Instrument** (NDICI-Global Europe) and the **Instrument for Pre-Accession Assistance** (IPA III) – are the main tools for international climate finance as part of the EU Budget.

The NDICI – Global Europe has a total budget of EUR 79.5 billion, and aims to promote global stability, address common challenges such as climate change and foster cooperation. IPA III's main objective is to support the beneficiaries in adopting and implementing the EU *acquis*, including on climate action, with a view to Union membership. NDICI – Global Europe is the main source of the European Commission's international public climate finance to EU partner countries. **Around 31% of NDICI budget – approximately EUR 24.5 billion – are estimated to be dedicated to climate action objective**s for the current period. For the period 2021-2027, the IPA III budgetary envelope is EUR 14.162 billion, with actions expected to contribute 18% of the overall financial envelope to climate objectives, with the objective of increasing this percentage to 20%[51] by 2027.

Article 8.8 of the NDICI regulation also highlights that programmes and actions funded by this instrument "shall mainstream the fight against climate change, environmental protection, human rights, democracy, gender equality and, where relevant, disaster risk reduction, and shall address interlinkages between the SDGs, to promote integrated actions that can create co-benefits and meet multiple objectives in a coherent way.[…]. They shall be guided by the principles of 'do no harm' and of 'leaving no one behind'."

[51] The 20% stems from the IPA legal base and add that this percentage is likely to be exceeded according to the latest estimates in the Programme Statement on IPA published here: https://commission.europa.eu/strategy-and-policy/eu-budget/performance-and-reporting/programme-performance-statements/instrument-pre-accession-assistance-ipa-iii-performance_en#contribution-to-horizontal-priorities.

Box 3: The Global Gateway strategy

The Global Gateway is the EU's contribution to narrowing the global investment gap worldwide. It is in line with the commitment of the G7 leaders from June 2021 to launch a values-driven, high-standard, and transparent infrastructure partnership to meet global infrastructure development needs. The Global Gateway is also fully aligned with the UN's Agenda 2030 and its Sustainable Development Goals, as well as the Paris Agreement.

Between 2021 and 2027, Team Europe, meaning the European union and its EU Member States, including their implementing agencies and public development banks, as well as the European Investment Bank and the European Bank for Reconstruction and Development jointly, will mobilise up to EUR 300 billions of investments for sustainable and high-quality projects, considering the needs of partner countries and ensuring lasting benefits for local communities. This will allow EU's partners to develop their societies and economies, but also create opportunities for the EU Member States' private sector to invest and remain competitive, whilst ensuring the highest environmental and labour standards, as well as sound financial management. Key areas of intervention include Digital, Climate and Energy, Transport, Health, Education and Research.

In 2016, the EU developed the mainstreaming guidelines[52] "Integrating the environment and climate change into EU international cooperation and development". These guidelines provide a framework for strengthening the contribution of EU international cooperation and development policy to sustainable development by integrating, or mainstreaming, environmental and climate change considerations into the different phases of the EU programme and project cycle. A revised version of these guidelines is under preparation in 2024, as a Greening Toolbox, aligned with the new external instruments (NDICI-Global Europe and IPA III as well as the new instruments Ukraine Facility and the Growth Plan for Western Balkans) and reflecting the new approaches towards cooperation. In particular, the new guidelines will address specific opportunities and challenges in support to investments in the form of provision of guarantees and the use of innovative financial instruments. Moreover, they will reflect the emphasis of coordinated action at EU level (Team Europe) and the need to promote an enabling environment and address green and social priorities under the 360-degree approach of the EU Global Gateway Investment Agenda.

Despite efforts, there still remains a large financing gap for climate action in fragile and conflict-affected settings, which are in great need of more consistent and better targeted climate finance in order to build resilience to climate impacts. Currently, countries in conflict receive around compared to USD 2.74 per capita compared to USD 7.19 per capita in non-fragile and conflict affected

[52] The EU guidelines on greening cooperation will be updated in 2024 to reflect the European Green Deal.

countries (World Bank Group 2024, forthcoming). To reflect commitment to addressing this funding gap, the EU became a signatory of the COP28 Declaration on Climate, Relief, Recovery and Peace, together with other governments, international and regional organisations and financial institutions, philanthropic and private sector entities, and organisations from the climate, environment, development, humanitarian, and peace sectors. A Secretariat has been set up to take this work forward.

Reflecting the increasing importance of using public finance to mobilise private investment, the **European Fund for Sustainable Development Plus (EFSD+)** was launched in June 2021 to enhance the mobilisation effect of EU’s international public finance. Financed under NDICI – Global Europe, it supports EU's overall objective to promote sustainable (public and private) investments in our partner countries. It is complemented by the Western Balkans Investment Framework, financed through IPA III, and specifically dedicated to the Western Balkan regions, and the Investment Facility for Türkiye. Investments contribute to delivering on the three overarching global EU priorities: the Green Deal, Global Gateway, Jobs and Sustainable Growth.

EFSD+ channels guarantee coverage and blended finance contributions through partner International Financial Institutions (IFIs), which by their end finance projects. Partner IFIs are mostly European and multilateral development banks, which have been “pillar-assessed” and certified under the financial regulation to manage EU funds. The current pillar assessment does not check the environmental and social management of the partner IFIs but most of them have a sustainability framework including strategies, policies and standards.

Box 6: Just Energy Transition Partnerships (JETPs)

The JETPs are a model for how the international community can work with partner countries to commit to a sustainable development trajectory and jointly implement a clean and just energy transition. The approach aims to bridge financial support together with ambitious climate targets and the necessary policy reform to achieve those. Working together, donors and host countries identify the necessary policy change to facilitate investments in the clean energy transition. The necessity to establish such an enabling environment is probably valid for all countries willing to enhance the consistency of investment with Paris Agreement objectives. JETPs are therefore an excellent initiative to support effective policy changes that ensure a just transition. Financial contributors include the G7 members and a few likeminded partners (grouped in the International Partners Group, IPG).

Four JETPs have been concluded, namely with South Africa, Indonesia, Viet Nam and Senegal. The EU is co-leading the JETP with Viet Nam (together with the UK). Investment plans have been already published for South Africa, Indonesia and Vietnam, while Senegal is preparing such strategic approach.

The G20 Task Force for the Global Mobilisation against Climate Change, launched by the G20 Brazilian Presidency in 2024, will work on how to enhance the role of country platforms and just national transition plans. JETPs have been identified by several stakeholders of the Task Force as a good example in that regard.

2.3.4.1. Climate change in the EU humanitarian budget

The European Commission continues to **factor climate and environmental risk considerations into its humanitarian actions**, in line with its commitments in the 2021 Communication on the EU's Humanitarian Action: new challenges, same principles. One of the priorities of the dedicated budget line for preparedness focuses on climate and environmental resilience. **In 2023, the European Commission dedicated EUR 78 million to disaster preparedness activities**, including for supporting communities to prepare for the impacts of climate change, and aimed to mainstream disaster preparedness across EU funded humanitarian actions through making interventions risk-informed. The European Commission underlines the importance of investing through all available funding sources in the resilience of the communities most at risk to climate change, thereby alleviating the impact of climate shocks on these communities. Additionally, the European Commission ensures that the environmental footprint of humanitarian aid operations is reduced, for example through switching from diesel generators to solar systems, thus contributing to climate change mitigation.

All the above contributes to the voluntary tracking of EU climate-related expenditure from the EU's humanitarian aid budget. The budget is not subject to the 30% climate mainstreaming target under the EU's 2021-2027 multiannual

financial framework, but it was a commitment made in the 2021 Communication on the EU's Humanitarian Action: new challenges, same principles.

2.4. EU actions supporting the alignment of financial flows with the Paris Agreement outside the EU

2.4.1. International Platform on Sustainable Finance, High Level Expert Group on sustainable finance and EU efforts in low- and mid-income countries

The EU is promoting key initiatives to leverage additional private finance for sustainable investments in partner countries. The **International Platform on Sustainable Finance** aims to scale up the mobilisation of private capital towards sustainable investments, by offering a multilateral forum of dialogue between sustainable finance policymakers. Through the platform, its members exchange and disseminate information to promote best practices, compare initiatives and identify barriers and opportunities, while respecting national and regional contexts. Where appropriate, willing members can further strive to align their initiatives and approaches. The platform, a knowledge partner of the G20 Sustainable Finance Working Group, has focused its work on the comparison of members' taxonomies and promoting genuine transition finance.

The **High-Level Expert Group (HLEG) on scaling up sustainable finance** in low- and middle-income countries (LMICs) was set up to identify the challenges and opportunities of sustainable finance in those countries and to provide recommendations to the European Commission. The European Commission dedicated significant work and effort over the past 18 months to support a diverse pool of experts on the HLEG in putting forward compelling recommendations for designing the upcoming strategy on sustainable finance in LMICs.

The report put forward by the HLEG was launched in April 2024[53], in the presence of IMF Managing Director Kristalina Georgieva. It focuses on how to increase mobilisation of resources from private capital to close the current SDG financing gap and to accelerate private financial flows for the implementation of the external dimension of the Green Deal.

The **Global Green Bond Initiative (GGBI)**[54], steered by the European Commission and the European Investment Bank, is a flagship Global Gateway

[53] High-Level Expert Group, Final Recommendations, April 2024, HLEG Final Recommendations (europa.eu).

[54] For More information: Capacity4dev, Global Green Bond Initiative, https://capacity4dev.europa.eu/resources/team-europe-tracker/partner-countries/global/global-green-bond-initiative-ggbi_en.

initiative promoting the development of green bond markets in low- and middle-income countries. Given, that the European green bond market is the biggest and most advanced in the world, the EU wants to share its expertise with its partner countries. The GGBI, announced and steered by President Ursula von der Leyen, brings together European development finance institutions and multilateral development banks to contribute to the effort. The Initiative has already received public investment commitments of close to EUR 1 billion. The GGBI is a key coalition initiative of the Paris Pact for People and the Planet (4P), championed by President Macron. The GGBI has also been highlighted in the G7 Leaders' Communiqué in June 2024.

The **Sustainable Finance Advisory Hub** is a Team Europe Initiative under the Global Gateway providing a single-entry point for demand-driven and high-quality technical assistance to EU's partner countries to develop sustainable finance ecosystems and promote sustainability-related instruments. The Hub has been designed as a truly coordinated initiative to ensure high synergy and impact. The EIB, EU, UN organisations, development agencies, Development Financial Institutions, and regional development banks have been preparing this initiative together. The technical assistance, an answer to continuous calls from the G20, will be provided through a strategic network of implementing partners on the ground.

The Hub will help LMICs develop credible sustainable finance frameworks (taxonomies, disclosure requirements, standards) while promoting interoperability with already existing international standards. Through the Hub, the European Commission intends to step up its support in comparing EU and national and/or regional taxonomies in LMICs, contributing to enhance interoperable frameworks and provide support to increase their transparency, visibility, recognition and use by the markets. A study comparing the EU taxonomy and the South African taxonomy was published in 2022, and several other similar comparisons have been completed (Colombia) or are currently being carried out (Mexico and Mongolia).

2.4.2. Export credits

Enhancing opportunities and better export finance conditions can boost green innovation and accelerate export oriented green investments and production. The Global Gateway Joint Communication[55] underlined that "the EU is exploring the possibility of establishing a European Export Credit Facility to complement the existing export credit arrangements at Member State level and increase the EU's overall firepower in this area". In this regard the European Commission has followed up on the commitment and published in April 2023 a Joint Staff

[55] Joint Communication to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank "The Global Gateway", JOIN(2021) 30 final of 1.12.2021.

Working Document[56] on the main outcome. In March 2022, the European Council recognises the role of **officially supported export credits in promoting and supporting a shift in investment patterns towards climate-neutral, climate-resilient projects.** It is therefore essential that Export Credit Agencies (ECAs) are aligned with their governments' climate change commitments and the Paris Agreement.

According to the 2024 OECD report on Climate Finance and the USD 100 Billion Goal[57] , export credit agencies provided a total of USD 2.4 billion in support of climate action in 2022 – up from USD 1.9 billion in 2020. By further aligning their activities to climate neutral and climate resilient investments, they could be instrumental.

At the international level, the EU is in the driving seat of efforts at the OECD to align the rules governing the provision of officially supported export credits with the goals of the Paris Agreement. The modernisation of the Arrangement on Officially Supported Export Credits was successfully concluded in June 2023. The changes constitute a milestone especially for European exporters as EU ECAs are the major providers of export credits among the 11 Participants to the Arrangement. The modernised agreement redirects public finance in coherence with the EU's climate goals as it creates extra incentives for climate-friendly transactions. It expands the scope of green or climate-friendly projects eligible for longer repayment terms, such as projects related to environmentally sustainable energy production; CO_2 capture, storage, and transportation; transmission, distribution, and storage of energy; clean hydrogen and ammonia; low emissions manufacturing; zero and low-emission transport; and clean energy minerals and ores. The final agreement avoids the risk of greenwashing and creates certainty for exporters and their banks by using clear and concrete standards and definitions.

The EU's most important effort in the OECD now is to revise Article 6 of the Arrangement which bans official export credit support for unabated coal power generation (this milestone ban was achieved in October 2021, driven by the EU proposal). The goal now is to extend this ban to the entire fossil fuel energy sector, to include exploration, production, transportation, storage, refining, distribution of coal, crude oil, natural gas, and unabated power generation not only from coal, but also crude oil, natural gas and its derivatives. The EU proposed such ban in the meeting of the Participants in November 2023. The negotiations are ongoing, with the goal to reach the agreement in 2024.

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56 JOINT STAFF WORKING DOCUMENT Main outcomes of the mapping of external financial tools of the EU, SWD(2023) 96 final pdf (europa.eu).

57 OECD, *Climate Finance Provided and Mobilised by Developed Countries in 2013-2022*, 2024, 19150727-en.pdf (oecd.org).

3. THE GLOBAL CONTEXT

The UNFCCC is the main international reference forum for the operationalisation of Article 2.1c. of the Paris Agreement. Discussions are progressing slowly, mainly due to the lack of a shared understanding of what ensure consistency of finance with the goals of the Paris Agreement entails, and the respective roles of national governments, international partners, and the private sector. Furthermore, until now, the discussion between the Parties of the Paris Agreement on its Article 2.1c is mainly focused on the relationship between Article 2.1c and Article 9 (Sharm el Sheik Dialogue), with the latter concerning the international climate finance to support developing countries in their effort for climate action. From the EU's perspective, Article 2.1c is central to enhance the mobilisation of climate finance at scale, and should feature prominently as part of the definition of the post-2025 climate finance goal, the New Collective Quantified Goal (NCQG) to be agreed upon at the UN Climate Change Conference in November 2024, and which will replace the USD 100 billion goal.

Despite increasing climate finance flows (according to CPI (2023) [58], annual average reached almost USD 1.3 trillion in 2021/2022), climate finance is still not sufficient to support the necessary actions to keep 1.5°C within reach, and to build a climate resilient future. Estimates of investment needs abound. For instance, the IEA (2021)[59] estimates that about USD 4 trillion per year needs to be invested in renewable energy up until 2030 to be able to reach net-zero emissions by 2050, while UNEP (2022) [60] indicates a global investment need of at least USD 4–6 trillion per year for mitigation. This means that climate finance must increase as quickly as possible, to avoid the worst impacts of climate change and support adaptation and resilience.

The Intergovernmental Panel on Climate Change (2023)[61] clearly indicates that "there is sufficient global capital to close the global investment gaps to reach the Paris Agreement but there are barriers to redirecting global capital to climate action". These include challenges in assessing and integrating climate-related risks in financial decisions, limited institutional capacities and local capital

[58] Climate Policy Initiative (2023), Global Landscape of Climate Finance 2023 Barbara Buchner, Baysa Naran, Rajashree Padmanabhi, Sean Stout, Costanza Strinati, Dharshan Wignarajah, Gaoyi Miao, Jake Connolly and Nikita Marini, https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2023/.

[59] International Energy Agency (IEA), *Net Zero by 2050, A Roadmap for the Global Energy Sector*, 2021, https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf.

[60] United Nations Environment Programme, *Emissions Gap Report 2022: The Closing Window — Climate crisis calls for rapid transformation of societies — Executive Summary*, 2022, Nairobi. https://www.unep.org/emissions-gap-report-2022.

[61] IPCC, 2023: Sections. In: Climate Change 2023: Synthesis Report. Contribution of Working Groups I, II and III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change [Core Writing Team, H. Lee and J. Romero (eds.)]. IPCC, Geneva, Switzerland, pp. 35-115, doi: 10.59327/IPCC/AR6-9789291691647.

markets, as well as high level of indebtedness and economic vulnerability of developing counties.

Many developing nations face significant investment challenges, compounded by rising debt levels and increased capital costs. These challenges are often overshadowed by immediate national development priorities such as healthcare and education. Addressing these issues in a coherent way requires broad structural reforms to support both decarbonisation efforts and resilient development.

This goes beyond the context of the Paris Agreement, as it requires transition towards a new paradigm of climate finance, characterised by enhanced availability, quality and accessibility of funds. Reforming the International Finance Architecture (IFA)and innovative finance sources have a clear role to play, to enable addressing climate finance and other global challenges within the 2030 Sustainable Development Goal Agenda and fairer debt management of developing countries.

3.1. Global, plurilateral and national initiatives

This broad international debate to redesign the global financial landscape and better finance common goods is largely dominated by financing climate action and making Article 2.1c operational to mobilise climate finance at the scale needed. For instance, the **Bridgetown initiative**, a policy initiative championed by the prime minister of Barbados, pitches a set of bold propositions to reform the international financial architecture and secure adequate funding for climate action in vulnerable countries facing climate change and sovereign debt, by creating new and innovative sources from which developing countries can borrow to mitigate emissions and build climate resilience.

The Summit for a New Global Financing Pact, which took place in Paris in 2023, aimed to lay the foundations for a renewed international financial system, creating conditions for a financing breakthrough so that no country has to choose between reducing poverty, combating climate change, and preserving biodiversity. The Summit outcomes are captured in several documents: the **Paris Pact for People and the Planet**; the Chair's Summary of Discussions; the Proposed Roadmap to build on key milestones of the international agenda as a follow-up to the Summit on a New Financing Pact; and the Multilateral Development Banks vision statement.

African Heads of State and Government who were present at the **Africa Climate Summit** in Nairobi, Kenya (4-6 September 2023) unanimously adopted the 'Nairobi Declaration', as a basis for Africa's common position in the global climate change process. The Declaration highlights the need to tap into innovative sources of finance, and the opportunities of climate action.

The G7 provides leadership for international climate action. The G7 Climate, energy and environmental Ministerial communiqué of Torino, April 2024, clearly indicated the crucial role played by the implementation of Article 2.1c in scaling-up and mobilising finance for climate action in all countries, including developing countries. It recognises the need to advance on the implementation, monitoring and tracking of the alignment of finance flows, and to provide consistent, comparable, and reliable information for market participants. It also recognises the centrality of Article 2.1c in the design of the post-2025 climate finance architecture under the Paris Agreement (the "New Collective Quantified Goal"). The G7 ministers commit to take actions towards these objectives.

Over the years, climate finance has become central also in the G20. The Sustainable Finance Working Group, for instance, is mandated to identify institutional and market barriers to green finance. Furthermore, in 2024, the Brazilian G20 Presidency has established a Task Force on "Climate Mobilisation Against Climate Change" consisting of two actions (resetting actions and resetting finance). Aspects that the Task Force is considering include innovative finance approaches, the necessary macro-fundamentals for a conducive business environment, ways to better leverage private capital and to reform the international financial architecture to further support the mobilisation of financial resources for climate action. The discussions and developments under other G20 working groups and initiatives will also feed into the Task Force work. For instance, in 2024, the G20 Sustainable Finance Working Group works on optimising the operations of the International Environmental and Climate Funds to enhance access to climate finance and increase the collective impact of Vertical Funds (Adaption Fund, Climate Investment Funds, Global Environment Facility and Green Climate Fund).

In addition to plurilateral fora, several initiatives have emerged around the world to mobilise public and private sector to provide capital towards low carbon and climate resilient development and reforming the global finance architecture. This includes shifting financial flows away from environmentally and socially harmful economic activities and re-orienting them toward a climate neutral and resilient socio-economic development.

The pivotal role of economic instruments in achieving climate goals by encouraging a switch to more sustainable choices as part of a socially fair green transition is at the core of the **Global Solidarity Levies Taskforce** (formerly known as International Tax Task Force) which was launched at COP28. Co-chaired by Barbados, France, and Kenya, the Taskforce brings together countries from around the world to explore feasible, scalable, and sensible options for climate levies, aimed at raising revenue for the fight against climate change and to provide economic development while protecting natural resources and social welfare. It focuses on taxation options that have already been implemented in some countries or that have gathered momentum in the

context of the New Global Financing Pact Summit and the Nairobi Declaration, with the objective of putting forward proposals by COP30.

The **Coalition of Finance Ministers for Climate Action**, established in 2018, brings together to date fiscal and economic policymakers from 92 Members countries representing 43% of global carbon emissions and 69% of global GDP. They aim to lead the global climate response and secure a just transition towards low-carbon resilient development. Participating ministers have signed on to the 'Helsinki Principles'[62] that promote national climate action, especially through fiscal policy and the use of public finance. The Coalition of Finance Ministers' members share their national experiences and identify transformative actions that finance ministries could emulate globally, such as actively using their budgets to drive transformation in all sectors of the economy or to push forward the green transformation of other state-owned vehicles like state-owned enterprises or sovereign wealth funds.

In 2023 the Trade Ministers of the European Union, Ecuador, Kenya and New Zealand launched the **Coalition of Trade Ministers on Climate**, now bringing together about 60 ministers with the objective of breaking silos between trade and climate communities. The work of the Coalition aims to show that trade, and trade policy, can – and must – do more to tackle the global climate crisis and help the global transition to net-zero. The Coalition has organised a first-ever dialogue between trade, finance, and climate ministers in the margins of the World Economic Forum in 2023. The aim was to exchange ideas on how trade and finance can help deploy the necessary technologies and investments to achieve our climate mitigation and adaptation goals - for example, through trade-related finance – including for the most vulnerable countries.

3.2. Enhancing synergies between climate change action and biodiversity

There is a wide recognition that the climate change and biodiversity loss are interconnected: aligning public and private financial flows is key for effectively addressing the triple ecological crisis of climate change, biodiversity loss and pollution. Like he Paris Agreement, the Kunming-Montreal Global Biodiversity Framework (GBF) contains provisions on ensuring consistency and alignment of financial flows with biodiversity objectives. Coherence when implementing the provisions of the Paris Agreement and the Kunming-Montreal Global Biodiversity Framework is crucial not only for effectiveness but to reach both climate and biodiversity global goals. For instance, climate resilient development that combines strategies to adapt to climate change with actions to protect natural resources and biodiversity (e.g. nature-based solutions) can

[62] Align policies with the Paris Agreement; share experiences & expertise; promote carbon pricing measures; mainstream climate in economic policies; mobilise climate finance; engage in NDC development. Helsinki Principles | Coalition of Finance Ministers (financeministersforclimate.org).

achieve multiple objectives at the same time. It is crucial that such synergies are highlighted and sought wherever possible in everyday decision-making and policies across all sectors, including energy, industry, health, water, food, urban development, housing and transport. It is about successfully navigating the complex interactions between these different systems so that action in one area does not have adverse effects elsewhere and opportunities are harnessed to accelerate progress towards a safer, cleaner and fairer world.

Investments should be positive for both climate and biodiversity. The COP28 Global Stocktake refers to the need for enhanced support and financing to reverse deforestation and forest degradation, or preserving and restoring ocean and coastal ecosystems, by conserving biodiversity in line with the GBF. Furthering the use public and private finances for an integrated implementation of climate change and biodiversity policies and commitments and fostering the development of nature-based solutions are necessary pathways that need to be further strengthened.

Box 7: The Kunming-Montreal Global Biodiversity Framework

The Kunming-Montreal Global Biodiversity Framework (GBF), which was adopted at the 15th Conference of the Parties of the UN Convention on Biological Diversity in Montreal, Canada in 2022, is a historic deal for nature that complements the Paris Agreement. The Kunming-Montreal Global Biodiversity Framework reiterates the interlinkages and commits to “optimizing co-benefits and synergies of finance targeting the biodiversity and climate crises”. The Kunming-Montreal Global Biodiversity Framework includes four outcome-oriented goals for 2050 and 23 action-oriented global targets for 2030 to achieve the 2050 Vision of living in harmony with nature and the 2030 Mission to halt and reverse biodiversity loss. A dedicated target (Target 8) recognises the interlinkages between climate change and biodiversity loss calling on parties to minimise the impact of climate change and ocean acidification on biodiversity and increase its resilience through mitigation, adaptation, and disaster risk reduction actions, including through nature-based solution and/or ecosystem-based approaches, while minimising negative and fostering positive impacts of climate action on biodiversity.

Furthermore, Goal D and Target 14 provide, for aligning all financial flows with the new GBF. The framework also includes strong targets for mainstreaming biodiversity across sectors (target 14) and for ensuring a strong contribution by businesses and financial institutions (target 15). Public and private financial flows must no longer contribute to destroying nature but become nature positive. We need to move from “do no significant harm” towards “do more good”. From the project to the strategic level, exploring the potential of nature-based components should be the norm, not the exception.

The targets for resource mobilisation (targets 18 and 19) are ambitious and encompassing. At CBD COP15, Parties agreed to increase global biodiversity finance to USD 200 billion per year from all sources: domestic and international, public and private. A commitment to increase international biodiversity finance from USD 10 to 20 billion by 2025, and USD 30 billion by 2030 is also part of the agreement. They also provide for the elimination, phase out or reform of incentives harmful to biodiversity, starting with the identification of subsidies by 2025 at national level, and then eliminate a total of at least USD 500 billion per year of biodiversity harmful subsidies by 2030.

3.3. Actors of the international climate finance landscape

The governance of the global climate finance landscape is characterised by a fragmented constellation of actors – state actors, public institutions, and many multilaterals, transnational, national, subnational non-state actors, as well as hybrid institutions. On the one hand, public institutions include governments, multilateral development banks, financial mechanisms such as the Adaptation Fund (AF) Green Climate Fund (GCF), the Climate Investment Fund (CIF) the Global Environment Facility (GEF). On the other hand, numerous private and hybrid institutions (Civil Society, Alliances, Media, Think Tanks, Academia) are

also involved in governance, influencing market players and adding further complexity to the structure.

In the last years the private sector has showed an increasing interest in disinvesting from carbon intensive activities and investing in climate neutral and climate resilient initiatives. Commercial and investment banks as well as large institutional investors (e.g. pension funds, insurance companies) are all fundamental actors in allocating capital for climate change related investments. There are however important barriers, like underdeveloped capital markets, higher risks, and unfavourable investment conditions in emerging markets and developing countries which often hinder private sector capital flow. Therefore, a multitude of financial and non-financial instruments are necessary to help leverage and mobilise private sector finance for climate change investments.

In this respect, the main actors are public actors, governments and state apparatuses that enable climate finance through setting the policy and regulatory framework such as taxonomies or carbon pricing mechanism, providing direct funding, or offering guarantees de-risking private investments. As such, public actors so far have been driving the implementation of Article 2.1c.

In relation to the functioning of the financial markets, central banks and regulatory actors have started to take into account the climate change risks in their decision making, relating both to physical and transition risks, thereby contributing to making finance flows consistent with the Paris Agreement. Their focus can be classified in two main groups: micro-prudential regulations and macro-prudential regulations.

3.4. The role of Multilateral Development Banks and Development Financial Institutions

Multilateral Development Banks (MDBs) and Development Financial Institutions (DFIs) play a crucial role for the mobilisation of funds for climate change mitigation and adaptation at large scale. They are supranational financial institutions that essentially provide grants, technical assistance and repayable forms of support (debt and equity). They can also attract commercial investors directly to projects by improving the risk-adjusted returns from long-term investments via risk mitigation tools. MDBs and DFIs can also mobilise investment indirectly by supporting governments in policy and regulatory framework related to climate socio-ecological transformation and broader investment policies (and related financial products), contributing to removal of specific barriers to investment, and thereby helping to create a more conducive investment environment. Moreover, their increasing role in fragile and conflict-affected settings is of paramount importance, as these contexts are among the most vulnerable to the impacts of climate change.

MDBs provide climate finance to support projects via co-financing (e.g. in public-private partnerships) or via de-risking of private 'green' investment. Within the global climate finance landscape, they also channel third-party funding. For example, some MDBs are responsible for implementing green finance projects by multilateral climate funds like the Climate Investment Funds (CIF). Similarly, many MDBs are Accredited Entities to the Green Climate Fund (GCF) and thus channel climate finance towards beneficiary countries.

MDBs have pledged to align their activities with the Paris Agreement and reinforce their commitment to contribute to combating climate change, thus implementing Article 2.1c. Since Kunming-Montreal COP in 2022, many also committed to support the GBF by mobilising finance for biodiversity and provide toolbox to mainstream biodiversity in their investments.

Calls for an evolution of the role of MDBs have intensified over the past year. For instance, in 2022, G20 Leaders called and urged MDBs to implement the recommendations of the G20 Independent Review of MDBs' Capital Adequacy Framework, and in 2024, the Brazilian G20 presidency aims to develop a new G20 Roadmap for better, bigger and more effective system of MDBs.

At the World Bank Spring meeting in April 2024 the leaders of 10 MDBs announced joint steps to work more effectively as a system and increase the impact and scale of their work to tackle urgent development challenges, including climate change. This includes continuing to align operations to the goals of the Paris Agreement and to jointly report on climate financing.

Box 8: The European Investment Bank and the European Bank for Reconstruction and Development

The **European Investment Bank** (EIB) is one of the world's main financiers of climate action and environmental sustainability. In 2020, the EIB Group adopted its EIB Group Climate Bank Roadmap for the period 2021-2025. The Climate Bank Roadmap lays out how the EU bank would support the European Green Deal and a just transition to low-carbon, climate-resilient and environmentally sustainable development.

The Climate Bank Roadmap committed the EIB Group to support EUR 1 trillion of green investment in the decade to 2030 and to align all its new operations with the Paris Agreement. In addition, the EIB committed to devote more than 50% of its financing to climate action and environmental sustainability by 2025. The Bank is on track to meet all these targets – notably, green financing reached approx. 60% of all investment in 2023. The EIB Group is aligning all new financing activities with the goals of Paris Agreement since 2021. The EIB Environmental and Social Standards serve as a reference in the market. They are periodically revised and since recently include a new Intermediated Finance Standard to address the need for financial intermediaries to assess, manage, monitor and report on the environmental, climate and social impacts and risks associated with the sub-projects they finance, as appropriate to the nature of intermediated financing.

The **European Bank for Reconstruction and Development** (EBRD) aims as well to be at the forefront of climate action, supporting the transition to a low-carbon world and adapting to the impacts of climate change in the economies where it operates. The EBRD has also adopted a 50% green target by 2025 for its financing and committed to align with the goals of the Paris Agreement by the start of 2023.

The Commission is in regular policy dialogue with both the EIB Group and the EBRD, thus contributing to ensure effective climate-target alignment and policy support.

4. TAKING STOCK, LESSONS LEARNED AND WAY FORWARD

Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development is a key driver for mobilising finance for the urgent transformation of the economy needed to simultaneously achieve the Paris Agreement objectives and pursue economic development. Achieving consistency of finance with climate change objectives should be seen as an **opportunity for economic and competitive growth** instead of an impediment, as it allows the mobilisation of finance to meet the necessary investment.

The overview of policies and tools already in place confirms that the EU has the tools to deliver results and **make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.**

With the European Green Deal, the EU has established a regulatory framework with ambitious **climate policies** (in particular clear emission reduction targets supported by **carbon pricing** through the EU ETS) and the **Sustainable Finance Framework** at its core, complemented by policies and tools that support the alignment of finance flows with climate objectives. This balanced and comprehensive policy mix has provided the EU with the necessary support to accelerate on the path to a net-zero and climate resilient economy and society.

When looking at total climate finance as defined by the Climate Policy Initiative[63]**, climate finance in Western Europe has increased from USD 101 billion in 2018 to USD 338 billion in 2022.** While such a threefold increase is impressive, the amounts mobilised remain below the level of investment needed to achieve the climate and energy targets of the EU.

Key to success is the **identification of synergies between climate action and other policy priorities, and their necessary financial underpinning**, for achieving economic growth, competitiveness, climate resilience and social fairness. The recent REPowerEU policy is an excellent example of such a comprehensive approach, where targeted policies and finance are mobilised to enhance access to clean and affordable energy, bringing multiple benefits to climate action, energy security competitiveness of industry and well-being of citizens.

A **balanced policy mix** is necessary for transitioning to climate neutrality and resilience: **carbon pricing, the sustainable finance framework, and the**

[63] Climate Policy Institute (CPI), *Global Landscape and Climate Finance*, 2023, [Global Landscape of Climate Finance 2023 - CPI (climatepolicyinitiative.org)](https://www.climatepolicyinitiative.org).

articulation of private and public finance through integration of climate objectives into public expenditure will continue to be the main levers to further strengthen this transition pathway, while aiming at enhancing coherence of finance with climate objectives.

These instruments have already contributed to the substantial redirection of financial flows to climate action and finance the transition to a climate-neutral and resilient Europe. As a matter of example, in 2023 the EU ETS raised around EUR 40 billion in revenues that will be used to finance climate action. When looking at the EU Taxonomy, capital investments into Taxonomy-aligned activities have significantly increased in 2024 compared to the previous year. Thus far, in May 2024, companies have already reported EUR 249 billion of investments, signalling significant growth compared with EUR 191 billion in 2023. The issuance of Green Bonds aligned with the principles of the International Capital Market Association reached more than EUR 200 billion in 2022 in the EU only; out of this, in 2022 almost EUR 25 billion were NGEU green bonds issued by the Commission[64]. Green loan volumes have been steadily increasing in the EU since 2016, reaching almost EUR 60 billion in 2022[65] while the assets under management of financial products referencing the EU Climate benchmarks reached an estimated EUR 116 billion in 2023[66]. In addition, the Recovery and Resilience Facility contributed to accelerating the EU's green transition with around EUR 275 billion in climate expenditures. To achieve climate neutrality by 2050 and mobilise the public and private investment needed, the EU will need to exploit the full potential of those tools and increase their reach, acting on existing levers.

The role of public finance could be further enhanced by better **targeting it to sectors and communities that are particularly vulnerable** and by building on existing and innovative tools at national and EU levels to **unlock additional public and especially private investments in strategic areas, to encourage investments into the production capacities in the EU for the net-zero technologies across the sectors, building** on the STEP approach, and to further de-risk private investment. The experience gathered with the implementation of instruments enhancing the interaction between public finance and private investments such as the RRF, InvestEU or the Innovation Funds can be leveraged in view of future EU Budget and new financing instruments.

Yet, public finance on its own will remain insufficient. The **EU Sustainable Finance Framework has started to accelerate the mobilisation of private finance both towards green investments and more broadly towards the greening of all investments**. Mandatory transparency on climate impacts,

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[64] Framework of NGEU green bonds is aligned with ICMA standards, Information on green bond issuances by the EU.

[65] European Commission, *Climate Action Progress Report 2023,* 24.10.2023, Climate Action Progress Report 2023 - European Commission (europa.eu).

[66] European Commission, *Questions and Answers on the Sustainable Finance package,*13 June 2023, QANDA_23_3194_EN.pdf (europa.eu).

risks and opportunities enables markets, authorities and stakeholders to know whether potential investments are aligned with the Paris Agreement and EU climate policies. Building on these foundations, **the EU's Sustainable Finance agenda should be pursued further**, also considering additional incentives. In addition, enhancing the **usability** of the Sustainable Finance Framework is a priority[67], including for SMEs.

Promoting credible corporate transition plans aligned with the goals of the Paris Agreement **and providing the tools to corporates and investors** for their assessment could greatly accelerate the transition. In addition, as harmful investments cancel out the benefits of sustainable ones, additional effort is needed to **re-orient finance away from harmful activities and towards climate objectives**. This will contribute to reducing financial lock-in in potentially stranded assets, exposing investors to climate change transition risks.

Furthermore, further efforts are needed to unlock financing for the green transition, maximising **public investment and de-risking private capital**, completing the **Capital Markets Union**, tackling the fragmentation of the EU financial markets.

The **effective implementation and expansion of carbon pricing in the EU and internationally** will also contribute to this goal, in line with the direction set in the Fit for 55 package. As demonstrated over the last year, this will continue to stimulate innovation, raise revenues to support decarbonisation and provide a significant incentive to abate GHG emissions.

Effectively exploiting and strengthening **synergies between climate and biodiversity actions would** ensure more efficient resource use and help to strategically address the interconnected planetary challenges of climate change, biodiversity loss and pollution.

This policy and legislative framework puts the **EU in a strong position in the international debate**, with the potential to inspire domestic reforms in other jurisdictions. At the international level, the lack of a shared understanding of the implications of and means for achieving coherence of finance flows with the goals of the Paris Agreement persists, coupled with different views on the respective roles of international and domestic actions, as well as the role of government, the private sector and international organisations.

This bottleneck can be addressed by a political discussion on the processes and rules that each country has or can put into practice in its own national reality to mobilise financial flows for climate actions and re-orient finance away from GHG intensive investments towards sustainable development priorities in

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[67] European Commission, Staff Working Document: *Enhancing the usability of the EU Taxonomy and the overall EU sustainable finance framework*, 2023, EUR-Lex - 52023SC0209 - EN - EUR-Lex (europa.eu).

line with national priorities. **The EU could contribute to this discussion by sharing its ongoing policies and commitments to achieve further progress toward alignment.**

To go beyond the fixed positions, this discussion should also consider **how the costs and benefits of the transition can be shared internationally**. The EU has also put in place a solid system to ensure that climate change is duly considered in all its external financing instruments. Building on the good experience so far with the climate change spending targets and mainstreaming guidance, **further strengthening the approach across the domestic and international funding instruments could bring additional benefits**. This could include a more coherent application of the 'do no harm' principle and the application of best practices in sustainability proofing infrastructure investments.

The definition of the post-2025 finance goal (New Collective Quantified Goal) under the Paris Agreement at the UN Climate Change Conference in November 2024 will be an important milestone. Support for developing countries should be consistent with the objectives of Article 2.1c, thus also creating the conditions for mobilising climate finance to the necessary scale domestically and internationally. The NCQG needs to support a new paradigm of climate finance, characterised by enhanced availability, quality and accessibility of funds, and innovative finance sources.

This is key to **guide the current debate on the reform of the global finance architecture and to go beyond the current fragmented approach** of several global and plurilateral initiatives for a systemic and substantial transformation of the economy and global financial assets.

Operationalising Article 2.1c should also be seen in the context of the next Nationally Determined Contributions (NDCs), which will need to be ambitious, and which will require a transformation of current financial assets to attract urgent and necessary investments from all sources, including the domestic and private sectors. This also applies to the EU, which in the Communication on "Securing our future Europe's 2040 climate target and path to climate neutrality by 2050 building a sustainable, just and prosperous society" (COM/2024/63 final) set out the elements that can inform the next EU NDC and the scale of the investments required.

It is therefore crucial to **define a viable new growth model to mobilise much more capital for climate action and unlock investments not only to achieve climate goals but also a more competitive sustainable economy**. To this end, it is necessary to move from an integrated to an all-inclusive approach that recognises climate and environmental actions as key pillars for economic growth, and for competitiveness and social fairness, while addressing possible trade-offs and necessary win-win partnerships.

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