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BRIEFING NOTE No. 132

# The EU budget and external climate financing:

## THE STATE OF PLAY

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Although the European Green Deal is primarily a domestic transition plan, its success very much depends on green transitions elsewhere. The EU's success as a global climate actor and partner rests also on the way it will use its external financing, both under the new Neighbourhood, Development and International Cooperation Instrument – Global Europe (NDICI) and through the European financial institutions for development. The latter will become more prominent due to their financial scale.

This note outlines the challenges and opportunities for mobilising the EU's resources to support its climate ambitions. While the political leadership has undeniably prioritised climate change, the next 18 months will be crucial to ensure that the EU translates its broad commitments into tangible actions through the programming of its external resources. To achieve its ambitions, the EU would need to take some steps, including adopting a climate justice perspective into EU climate action, credibly implementing the 'do no harm' principle and the commitment to align to the Paris Agreement, and exploiting the enhanced coordination envisioned by Team Europe.

European public financial institutions have made several commitments towards more and better climate finance. Moving forward, they could use their finances to better target low-income countries, strengthen the gender perspective of green investments, balance and use more synergically mitigation and adaptation funds, and improve coordination and risk sharing between them.

## Introduction[1]

The European Green Deal (EGD) policy framework is first and foremost a European domestic transition plan, yet European policy-makers are aware that its success very much depends on green transition elsewhere in the world. The external dimension of the EGD is gradually being articulated across different policy domains. While some details are starting to emerge, for example, on the EU's relations with the Southern Mediterranean or the Western Balkans, much remains to be determined and negotiated with partner countries and regional groupings (EC 2021a; EC 2021b).[2]

How the EU uses its external financing instruments to steer its international climate agenda will be a determining factor of the success of the EU as a global climate actor and for its effective engagement with its regional and bilateral partners across the world. The new 2021-2027 multiannual financial framework (MFF) or EU Budget overhauled and simplified the EU external financing architecture. It also introduced important new commitments towards climate financing.

The programming of EU resources under the Neighbourhood Development and International Cooperation Instrument - Global Europe (NDICI), the new instrument consolidating most funding sources for EU external action, is a crucial step that will set the tone for EU external financing in the years to come. Programming is a complex and highly political process of consultation, coordination, and prioritisation. Although it is due to be finalised in the first half of 2021, it will likely stretch towards the end of 2021. It covers the full seven year span of the EU budget and will therefore have a long-term influence on the objectives upon which the EU will put its financial weight.

The NDICI is the principal but not the only financing instrument of EU external action. More than half of overall EU climate change financing comes from European financial institutions and the other half by the European Commission. Jointly, the EU institutions and EU member states are the largest funders of climate change, although coordination and collaboration could be better exploited. The current programming exercise has significantly raised the ambitions to build a stronger consistency between these different strands of EU funding and to strengthen mechanisms for 'working better together' with EU member states, their implementing agencies and European financial institutions under the flag of Team Europe.

This note[3] outlines the challenges and opportunities for mobilising EU's financing to support its climate ambitions. It looks at the EU's on-budget resources under the MFF 2021-2027 (section 3.1) as well as at the role of the European financial institutions for development, including the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) and bilateral European development finance institutions (EU DFIs) (section 3.2). It offers an overarching view of the programming process and how some of the provisions of the programming guidelines can enhance climate objectives. The note concludes with some final remarks and recommendations for action.

Key policy recommendations include:

- While the prioritisation of climate change is undeniable, the next 18 months will require vigilance and knowledge-led engagement to monitor whether and how the EU translates its broad commitments into tangible actions.
- The EU has not adopted a climate justice perspective outside its borders. However, it could exploit the available financing opportunities to integrate such a perspective in external action to increase its impact and raise its credibility as a leading climate actor. Doing so will require a very different approach to the EU's internal just transition mechanisms, and calls for a clear focus on those countries and economies that will be hard hit by EU transition, and a wider focus on (a) vulnerable groups; and (b) the long-term and structural effects of climate change.
- The 30% climate target, the requirement to align EU spending to the Paris Agreement and 'do no harm' principle of the new EU budget reflect the high level of priority the EU is giving

to the fight against climate change and support a sustainable transition. However, the EU will need to pay attention to several areas, namely:

- Ensure a credible definition of how the EU financing aligns with the Paris Agreement and the 'do no harm' principle of the European Green Deal, and a thorough implementation of the EU climate principles in EU external financing to translate the EU's sustainable transition ambitions into tangible practice
- Work towards enhancing complementarity among EU programming processes (national, regional and global) and implementing partners to ensure a cohesive action and the exploitation of synergies
- Ensure the successful realisation of Team Europe and 'working better together' agendas for a more effective and impactful climate action
- Strengthen the EU ability to work collaboratively with multiple stakeholders and with climate champions to ensure local ownership and sustainability of actions

• While EU budgetary resources have a key role to play, a sustainable and just transition will require additional and significant resources from other public sources and private financiers. European public financial institutions have made several commitments to increase their climate finance and improve its quality. This process is ongoing, and further efforts are needed to, in particular:

- Better target finance geographically and by income group to ensure it addresses the most pressing climate vulnerabilities especially in low income countries
- Prioritise a gendered approach and inclusive sustainable transition initiatives
- Better balance combating climate change via mitigation financing with adapting to climate change (where consequences are already prevalent), ensuring a mutually reinforcing dynamic between the two
- Ensure a more cohesive European investment landscape, engaging in risk-sharing between DFIs to better address the existing climate financing gaps
- Employ a coordinated approach that utilises the existing climate action partnership platforms among Europe, Africa and beyond such as the EU-Africa high level platform on sustainable energy investments, the International platform on sustainable finance, and the EU platform on sustainable finance to better address shared priorities while ensuring harmonised taxonomies and policy dialogue.

## Putting EU climate change targets and principles into practice

The new EU budget and the accompanying extraordinary Next Generation EU fund (NGEU) adopted in December 2020 will have enhanced climate targets compared to the past MFF 2014-2020.[4] The Council Conclusions of July 2020 say that "climate action will be mainstreamed in policies and programmes" financed under the MFF and the NGEU and sets an overall climate target of 30% that will apply to all EU expenditures (European Council 2020a: 7). Furthermore, all EU spending will need to be compatible with the EU objective of climate neutrality by 2050, EU climate objectives for 2030, and be consistent with the Paris Agreement and the 'do no harm' principle of the Green Deal. While the initial proposal of NGEU included resources for EU external action, these were not retained in the final agreement, and the NGEU now has an exclusively domestic focus.

The same principles and the 30% climate target of the MFF apply to the €79.5 billion of the NDICI and are likely to be restated in its final legal text (EC 2020a; European Council 2020d). Programming guidelines

for the NDICI also require that climate change and environmental protection are mainstreamed throughout all programmes and actions. The NDICI also includes a consolidated External Action Guarantee (EAG) and a new European Fund for Sustainable Investments Plus (EFSD+), which together aim to mobilise private sector resources for EU external action through blending and guarantees. Climate provisions will apply also to these funds (section 3.2). Yet, the history of the programming of EU aid is often a case where high ambitions related to climate, while being well articulated on paper including into individual country strategies, often aren't fully followed through into effective implementation (Herrero et al. 2015).

**The EU needs to better define its climate principles**

While political level targets and principles are set, major challenges remain to translate these into practice in EU external investments and cooperation activities. In fact, the consistency of the EU expenditures with the Paris Agreement objectives and the 'do no harm' principle of the European Green Deal are to a large extent yet to be specified. A credible definition of how these principles would apply domestically and internationally and a thorough implementation is therefore needed. This is central to expedite the EU's sustainable transition ambitions and will ultimately also affect the perception of the EU as a global climate actor. Still, the EU has sometimes favoured ambiguity because of the difficulty to reach consensus across the institutions and with member states.

In an effort to develop a more consistent and concrete understanding of sustainability in EU financial operations, the EU recently approved a Taxonomy on sustainable investments. This exercise confirms a high level of political commitment and is seen to be the result of "an enormous collective effort of many parties and experts, [providing] a rigorous and concrete approach of sustainability" (Philipponnat 2020: p. 16; EC 2020). The Taxonomy establishes criteria and a list of environmentally sustainable activities with the aim of helping businesses, investors and policy-makers to shift investments towards a green transition. The Taxonomy develops the 'do no significant harm' principle based on the logic that economic activities that are not coherent with environmental sustainability or are not on the path to become so are harmful. This applies to climate change mitigation and adaptation as well as water and marine resources, circular economy, pollution and biodiversity (EU 2020: art. 17).

It is likely that EU funding under the EFSD+ will be implemented in accordance with this Taxonomy. However, whether the Taxonomy will also apply to the whole of EU external action resources is not clear. Extending the Taxonomy to all EU external resources or using it as a base for a similar approach for the whole of international spending may increase the consistency of EU action, but may also prove difficult to put into practice. Adapting the Taxonomy to the context of developing countries may require the EU to find a compromise between funding viable and relevant projects or a strict adherence to its own standards.

Civil society organisations have recently signalled that the above-mentioned efforts are welcomed but not sufficient. In particular, they highlight that the EU is not going far enough in phasing out fossil fuels globally and urge the EIB to be fully consistent with the 1.5 degree Celsius goal of the Paris Agreement (Can Europe 2020; Greenpeace 2020). In a joint statement, they called for environmental and climate screening for both mitigation and adaptation under the EGD in support of partner countries' post-covid recovery (ACT Alliance et al. 2020).

# Possible entry points for a climate justice framing

The effects of climate change are unevenly spread and unevenly felt across and within countries and communities. Vulnerable groups are most likely to suffer more from climate change impacts, either because of their geographical location or because of their limited access to vital resources and support networks (climate resilience). Climate change also exacerbates inequalities. Therefore, it is essential to

integrate a climate justice perspective, shifting the discussion from a purely environmental one to one that encompasses sustainable and inclusive development and the fight against inequalities as a whole.

Differently from the significant evolutions around climate principles and targets, instilling a climate justice perspective into EU financing still has to be done since the EU and member states do not use the wording in a context of climate finance and the global climate regime. However, the EU normative framework for climate action may provide some useful entry points for a climate justice-inspired approach at the operational level, including its rights-based development action that seeks to leave no-one behind and its support to the SDGs in general and the Paris Agreement.

On a global level, the EU's approach is going to be inevitably less ambitious than what global climate and environmental justice advocates call for. At the same time, there is growing recognition that the EU's ability to achieve its transition at home depends also on how legitimate the EU is seen as a global climate actor in the multilateral space and in its international partnerships as well as its ability to bring others along. To retain a degree of legitimacy and credibility as a climate actor, the EU will need to:

1. avoid contributing to further climate and environmental injustice;
2. target specific climate vulnerabilities; and
3. bear at least some of the costs related to an accelerated transition away from fossil fuels in key partner countries.

A social inclusion and human development framing can also offer an entry point to focus on climate vulnerabilities. The COVID crisis exposed the fragility of the development achievements so far and revamped the EU's interest and urgency to invest in human development. The NDICI incorporates a target to dedicate 20% of its aid to social inclusion and human development, equivalent to €14,8 billion in current prices. The newly released EU Gender Action Plan III (GAP III) reconfirms the commitment to achieve 85% of gender spending for new actions by 2025, a target that applies also to the NDICI (EC/HRVP 2020). So far, however, the EU has struggled to live up to its commitments to human development.

The challenge of integrating human development, gender and climate change into programming is one of choices rather than available opportunities. EU delegations in partner countries, together with headquarters, are now tasked with programming EU action on the basis of broad objectives rather than sectors. This is a less constraining and potentially more strategic approach than the one used in the past (when programming guidelines required to focus on three sectors alone).

This allows for a more holistic, intersectoral and synergic approach to international cooperation, which could, in principle, favour climate justice. Beyond a mere recognition of the interlinkages between human development and climate and environmental objectives, integrated approaches require framing programmes and initiatives in a way that creates synergies and exploits co-benefits. Potential examples are many: a sustainable forest management project could take into account women's economic empowerment; a renewable energy project can focus on reaching climate stressed communities and preserving their natural environment at the same time; policy dialogue on climate change could be conducted with a strong gender and youth lens. This is fully in line with the EU international partnership objectives and it will be critical to monitor whether and how this is put into practice in different contexts.

The Green Deal, Europe's renewable energy transition, and the principle of 'do no harm' are likely to cause shockwaves in energy imports and investment patterns of the EU and its member states in the medium term. Countries in the neighbourhood such as Algeria or Azerbaijan, but also other oil and gas exporting countries such as Nigeria or Peru, will be affected by the European transition. Supporting affected partner countries with forward-looking and context-specific measures that contribute to climate change results and a just transition for affected sectors will be crucial for the success of the Green

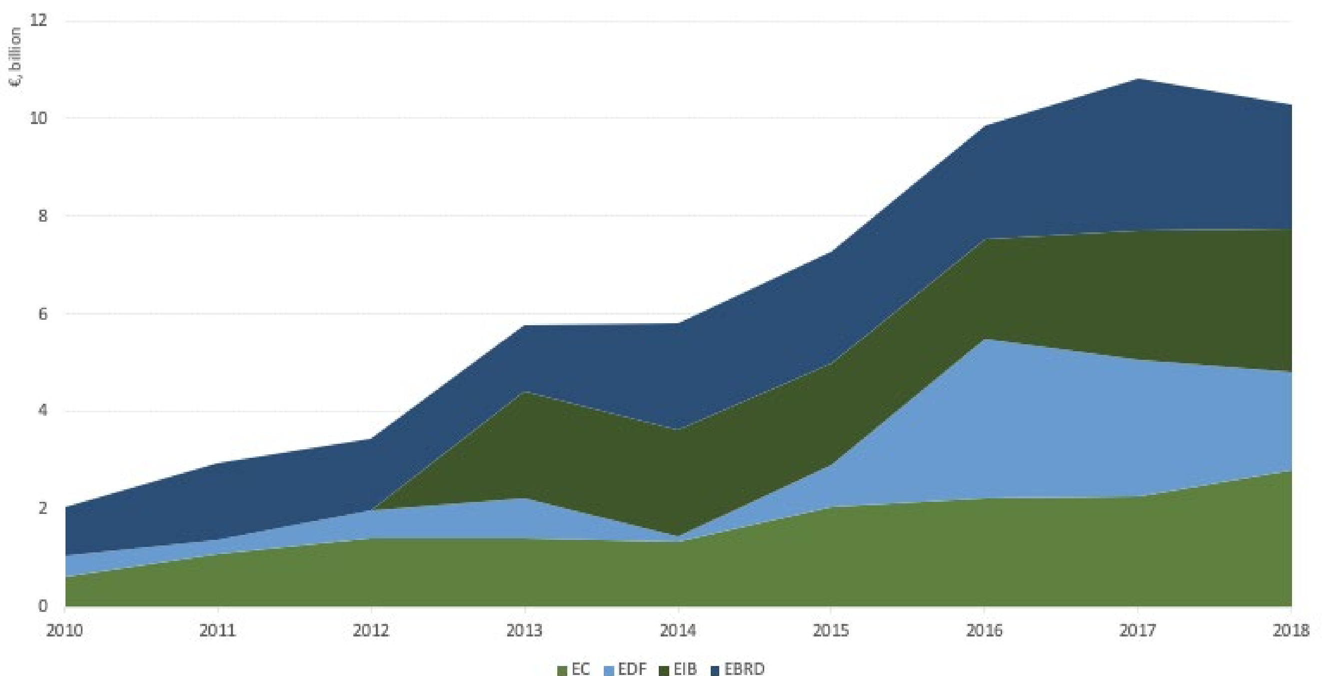
deal, climate change and the EU stance in the world (Leonard et al. 2021).

The focus of the EU's just transition efforts will be at home, especially through the EU just transition fund under EU Cohesion Policy and available funding rapidly diminishes the further away one looks from the EU. This is a reflection of the EU's own priorities and it is a hard reality to change. However, the programming process is an opportunity for the EU policy-makers to identify possible initiatives that can contribute to a socially just transition beyond the EU. These developments can enable the EU to mitigate the cascading external effects of the changes in the EU's internal energy mix, such as a reduced market for fossil fuels and its associated socio-economic effects.

## The EU's evolving climate financing architecture

This section looks at the opportunities and challenges that the new policy framework of EU external action financing offers, with a focus on the NDICI (section 3.1) and the role of EU banks in external climate change financing (section 3.2). Together, the European Commission (including funds under the now discontinued European Development Fund (EDF)), the EIB and the EBRD disbursed €10.3 billion of climate financing in 2018, the second largest amount since 2010, except for 2017. Over 2013-2018, the European Commission (including the EDF) disbursed on average 44% of EU climate financing and the EIB and EBRD combined 56%.[5] For a comprehensive overview of EU climate financing one therefore also needs to include the EU banks

**Figure 1 - The scale of EU climate finance**

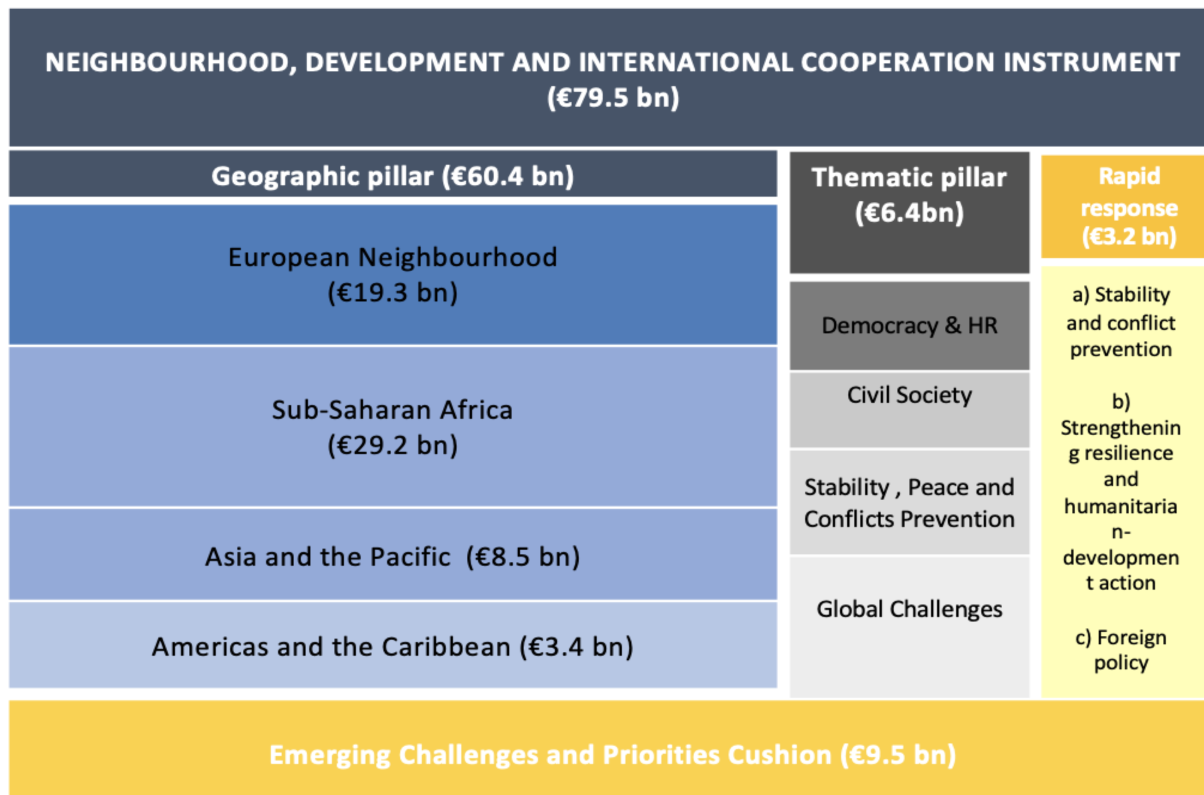



*Source: authors based on OECD DAC data. Notes: EC is European Commission; EDF is European Development Fund; EIB is European Investment Bank; EBRD is European Bank for Reconstruction and Development.*

## Climate action under the NDICI

The NDICI is a major break with the past as it consolidates a number of pre-existing European international financing instruments.[6] The instrument merges 11 external financing instruments, including the off-budget European Development Fund.

**Figure 2 - The structure of the NDICI**




*Source: ECDPM based on European Council 2021*

Of its €79.5 billion, three-quarters of resources will be allocated to countries and regions, especially in Africa (at least €29.2 billion) and the Neighbourhood (at least €19.3 billion). In turn, thematic programmes (e.g. on global challenges such as climate change) will be much smaller and focus on global and cross-continental initiatives much more than in the past.

In addition to the geographic and thematic allocations, funding for climate action can also come under the NDICI's Emerging Challenges and Priorities Cushion as well as the Rapid Response Action pillar. Both are non-programmable envelopes designed to better equip the EU to respond more rapidly and in a flexible manner to emergencies and new policy priorities (e.g. in the context of EU-Africa relations and beyond).

**Climate action can benefit from a more policy-driven EU external engagement**

The logic behind the NDICI is to better support the advancement of the EU objectives internationally and follow a so-called 'policy-first' programming principle.

This approach is meant to move away from past practice in which EU external spending was to a large extent driven by the financial instrument under which resources were allocated rather than by EU policy objectives. With the NDICI, the EU wants to be more strategic and use its resources more decisively to advance its international policy priorities. Since climate is such a central priority for the EU, climate action will likely benefit from this approach. Finding a match between partner governments' priorities and the EU on climate change action may be also easier than in other areas such as digital, migration or security. Reportedly, climate priorities are informing programming choices more than in the past, for example under the Team Europe Initiatives.

The NDICI also aims to promote policy coherence through a "stronger coordination between external and internal policies" and across different financing instruments (European Council 2020a: p. 14), specifically for the realisation of the Paris Agreement objectives and the SDGs, in line with the Green Deal

and for a sustainable post COVID-19 recovery. While it remains a challenge, inter-institutional coordination is becoming more central to the work of the European Commission. Under the Green Deal policy 'umbrella', several domestically-focused policies now include explicit references to an external dimension. This is the case of, for example, the EU Farm to Fork Strategy, the Circular Economy Action Plan and the recently established EU Strategy on Adaptation, which for the first time includes an international dimension (EC 2020e, 2020f; 2021b).

While the externalisation of the EGD is a work in progress, there is increasing recognition of the need to better integrate the international and domestic dimensions of EU policies. While these policy developments show a recognition of the need for better coordination, many bottlenecks still remain at the institutional level.

**Bridging different levels of action will be important**

The complexity and multilayered nature of climate change and the urgency of the response call for complementarity across national, regional and global action. This is needed to ensure consistency and effectiveness of EU actions under different funding streams and ensure coordination among the multiple actors involved. Funding for climate action will come from different envelopes under the NDICI as well as from other EU programmes under other Headings of the MFF. For example Horizon Europe, the €95.5 billion EU's Research and Innovation (R&I) framework programme supports international cooperation.

A strong push towards complementarity is needed to overcome fragmentation of EU action on climate, also building on past examples of synergies and innovative practices under the 2014-2020 MFF, for example under the Global Public Goods and Challenges Programme of the Development Cooperation Instrument or the Partnership Instrument (Particip 2015; EC 2017a). While the consolidation of instruments under the NDICI is an important step that can facilitate complementarity and the exploitation of synergies, it will not be enough. Further efforts are needed to improve inter-institutional coordination and to better link the different levels (national, regional and global) of the programming process.

**The success of Team Europe and 'working better together' are a condition for effective climate action**

Another layer of complementarity regards cohesive action across the EU family, including the EU Institutions, EU member states, the EU implementing partners such as the EIB, EBRD and bilateral EU DFIs (section 3.2). Systematic collaboration among them, pulling together resources at the political level, could have a tremendous impact on climate change. The EU takes every opportunity to stress that, when combined, the EU institutions and member states are the world's largest providers of climate finance (Council of the European Union 2020b). But the EU institutions and member states are still far from being a cohesive climate actor and collaboration has been ad-hoc so far.

The Team Europe approach, which emerged in the context of the EU's global response to COVID-19, provides opportunities for joint climate action. Team Europe initiatives are large and high-profile actions that aim to bring transformational impact by pooling resources and bringing together the EU family around shared objectives, in line with EU priorities and in the spirit of working better together. Team Europe Initiatives are being designed as part of the NDICI programming, many of which reportedly will have a climate change and environmental focus, for example on biodiversity, renewable energy, circular economy, food systems and others (Chadwick 2021).

The Team Europe brand has already been used during the EU's Climate Diplomacy Week in South Africa or for a forestry programme in Timor Leste. Team Europe has been positively received by member states and European financial institutions for development, although it still remains to be seen whether this approach will be able to overcome some of the more structural bottlenecks to joint working among EU actors (Jones and Teevan 2021; Bilal 2021).

**Effective climate action goes hand in hand with local ownership**

The so-called 'geographisation' of the NDICI means that most resources will be programmed starting at the most appropriate level, starting from the country level and going to the regional or global level only when it adds value. This also means that resource allocations are negotiated with partner governments and regional partners rather than at headquarter level and thematically. In order to be effective, EU climate action will need to respond to the needs, realities and interests of partner countries and societies. The programming process will need to tailor EU action to very different social, economic, political and environmental contexts, while ensuring a degree of coherence with EU broader climate objectives and the Green Deal.

In some contexts, there may be tension between the policy-first principle which aims to advance EU strategic policy objectives, notably in the area of green transition, and the alignment to partner country needs and country ownership (Jones and Keijzer 2021). Programming guidelines call for consultations beyond partner governments, with European, local and international actors, including civil society and the private sector. In the past, consultations with these actors have not always been meaningful and did not result in real multi-stakeholder cooperation. The rather strong non-governmental climate and environmental community offers new opportunities for collaboration at least in some contexts. Yet, it remains to be seen to what extent the EU delegations are well equipped in human resources capacity, expertise and direction for this sort of collaboration and what outcome ongoing consultations will have.

In the past, the EU has struggled to put climate high on the agenda of some of its country partners (Particip 2015). African governments especially argued that mitigation is a historic responsibility of the West and that a green transition would undercut their development and industrialisation objectives. Some African policy-makers are some of the strongest voices in favour of climate change action and some African governments are now looking at sustainable environmental ways to deliver their development agendas, jointly with their international partners.

The EU has an opportunity to build on this rising narrative and focus on specific partner country concerns, in line with their Nationally Determined Contributions (NDCs) as well as wider national development trajectories and specific vulnerabilities. Working with regional and national champions, whether in government or in society, and adapting the EU Green Deal priorities to fit to different national circumstances will also be essential for all EU external financing, including under the EFSD+ and among EU DFIs (section 3.2) (OECD 2020).

**Results under the NDICI will depend on broader EU external action on climate**

While the NDICI remains the principal funding instrument for international cooperation, two elements need to be considered. First, the extent to which the EU will be able to achieve climate change results will depend on the consistency, coherence, quality and integration of EU external action on this matter (like for any other). For maximum impact, the NDICI needs to be combined with other financing streams, diplomacy, trade, as well as work at national, regional and global level in a more synergic way. This requires a level of policy direction and interinstitutional collaboration that the EU has struggled to achieve so far.

In the case of China, for example, the EU institutions and member states combined political engagement, technical advisory and practical cooperation. This combination helped shift the priorities of the Chinese governments in favour of climate action and promoted the transposition of the European Emissions Trading System to China (Di Ciommo et al. 2018; Mathiesen and Colman 2021). This is far from a replicable example, but it does illustrate how the EU's climate action is intricately linked with its international and multilateral diplomacy. It also shows the importance of the external perception of the EU as a climate actor. The EU's legitimacy in the global climate regime and in its engagement with key potential partners such as the African Union will also depend on how it will use its own resources.

Second, some initiatives and funding streams beyond the EU's external action heading have greater significance for climate action than others. One example is the EU's R&I funding. International cooperation is a key feature of Horizon Europe that will fund joint research with middle-income countries (MICs), some of which are among the major emitters of greenhouse gases, and with African countries under the Joint EU-Africa Strategy (JAES). The first priority in the area of R&I under the JAES was food security and sustainable agriculture, launched in 2016, and the second one climate change and sustainable energy, launched in 2017, both with significant relevance for climate change.

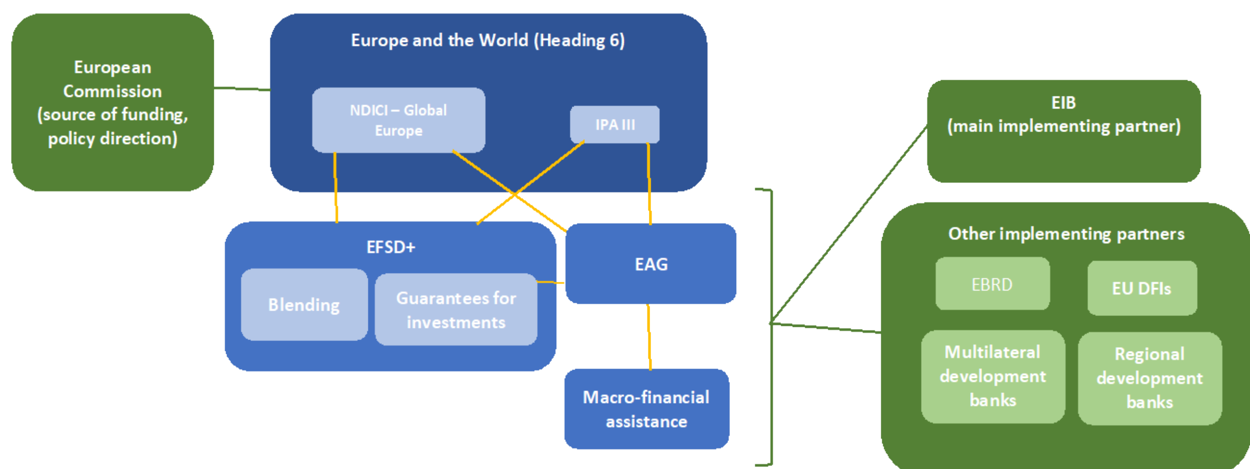
In 2020, the EU launched an ambitious €1 billion call under the Horizon 2020 programme, specifically to boost the green and digital transition. This initiative provides an opportunity for the European Union to cooperate with Africa to support the attainment of the SDGs and the Paris Agreement. Beyond sustaining with fresh knowledge and innovations the objectives of the EGD, this initiative also seeks to better position the EU private sector in the rapidly expanding renewables market outside its borders and carve a niche for strategic EU investments.

R&I international cooperation on climate issues remains highly strategic for the realisation of the EU ambitions. It is also an area that could benefit hugely from a more systematic cross-institutional collaboration in the EU and with member states, a stronger alignment to national research agendas and a better ability to sustain innovations (Di Ciommo and Thijssen 2019; Di Ciommo et al. 2019). The recent council conclusions on the European Research Area and the Communication on the same topic seem to convey an increased attention to collaboration with African countries and other low- and middle-income countries under Horizon Europe. The expected future EU strategy for international cooperation in R&I hopefully will build upon this interest (European Council 2020b; EC 2020b).

## Climate action in the wider EU financial architecture

The NDICI regulation establishes a streamlined investment framework for external action to help raise private sector funds for sustainable development with the EFSD+ and the EAG (Bilal 2019a). The EFSD+ builds on the EFSD under the 2016 External Investment Plan (EIP) and expands its geographical coverage and scope (EC 2020c, Bilal 2019a). The fund will provide assistance to developing countries in the form of guarantees, grants (blended finance), technical assistance and other relevant financial instruments. The EAG is a single guarantee mechanism, which builds on the previous EFSD Guarantee and the Guarantee Fund for External Actions. Figure 3 below gives an overview of the EU external resources landscape and its different components.

**Figure 3: The EFSD+ and the EAG**




*Source: Authors' elaboration. Note: graph only includes funds that are relevant to developing countries*

As the investment arm of the NDICI, the EFSD+ is meant to support the implementation of the EU's external policy priorities, including those of the European Green Deal. The NDICI regulation refers to the fight against climate change, the Paris Agreement, adaptation and mitigation action, and the protection and management of the environment as key intervention areas of the EFSD+ (European Council 2020d). The latest EU adaptation strategy also stresses that the EFSD+ will be an innovative mechanism to mobilise additional climate adaptation finance from the EU and its member states (EC 2021b, EC 2020c).

The EFSD+ will be structured around regional investment platforms within the Neighbourhood; sub-Saharan Africa; Asia and the Pacific; and Americas and the Caribbean, building on the existing regional investment facilities of the EU for blended finance (Bilal 2019a). For all the geographic programmes under the NDICI and thus, investment platforms, cooperation will revolve around addressing the global challenges that constitute the '5Ps,' that is: Planet (that will include environment and climate change)**;** People; Prosperity; Peace; and Partnerships (Council of the European Union 2020a).

The EFSD+ will be implemented through an open financial architecture in which the EIB will be the major implementing partner. However, the EBRD, the bilateral EU DFIs, and multilateral development banks, including non-European ones, such as the World Bank Group and the African Development Bank (AfDB), will also have potential access to the EFSD+ (EC 2020c; EC 2020d and 2021a). In all these arrangements, priority will be given to the EU implementing partners; multilateral as well as bilateral ones.

**The EIB in EU climate financing and its role as the EU climate bank**

The EIB is a key provider of EU climate finance and has now established itself as the EU's climate bank to promote the objectives of the European Green Deal within and outside Europe. In November 2020, the EIB released its Climate Bank Roadmap for the 2021-2025 period, outlining how it will "support the transition of the European Union to a low-carbon, climate-resilient and environmentally sustainable economy, taking an integrated approach inside and outside the EU" (EIB 2020). The EIB also stresses that as of 2021, all its operations are to be aligned with the Paris Agreement, including the phasing out of financing to fossil fuels. Particularly in developing countries, the EIB has stated it will partner with local actors to protect people, assets and the environment while protecting those most at the risk of climate change especially in Least Developed Countries (LDCs) and Small Island Developing States (SIDS) (EIB 2020).

The EIB was the largest financier of climate action globally in 2019 with commitments amounting to US$21.7 billion (MDBs 2020). However, 83.6% (US$18.1 billion) of the EIB climate finance is invested in high income countries, including the EU, which is its main focus of operation.

While the EIB also supports EU external policy objectives through its external lending mandate (ELM) (EC and EIB, 2013), its 2019 climate financing to low-income countries (LICs) and MICs amounted to a more modest US$3.6 billion, putting it well below other major global financiers such as the World Bank Group and regional banks such as the Asian Development Bank or the Inter-American Development Bank Group (Table 1).

**Table 1: Multilateral Development Banks climate finance**

| MDB | Low-income and middle-income economies | | | High-income economies | All economies |
|---|---|---|---|---|---|
| | Adaptation finance | Mitigation finance | Total climate finance | Total climate finance | MDB climate finance |
| *AfDB* | ***2016*** | ***1584*** | ***3600*** | ***0*** | ***3600*** |
| ADB | 1531 | 5537 | 7068 | 5 | 7073 |
| EBRD | 569 | 3354 | 3923 | 1079 | 5002 |
| *EIB* | ***387*** | ***3170*** | ***3558*** | ***18100*** | ***21658*** |
| IDBG | 1887 | 2531 | 4417 | 540 | 4958 |
| IsDB | 217 | 247 | 464 | 2 | 466 |
| WBG | 7329 | 11108 | 18437 | 369 | 18806 |

*Note: US$ million, commitments, 2019; Source: Adapted from MDBs (2020)*

The EIB as a climate bank intends to play a leading role to combat climate change both in Europe and abroad. The EIB also issued the world's first ever green bond, 'climate awareness bond' and remains the largest green bond issuer with about €34 billion raised across 17 currencies. The capital raised in bonds complements the EU budget financing for external action in supporting climate action particularly the renewable energy and energy efficiency sectors in and outside of the EU. However, for the EIB to lead globally, it will need to boost its climate finance in relation to other MDBs.

At the moment, regulatory, market and financial investment barriers both within the EU and outside limit the EIB's ability to foster climate change finance in developing countries. One limitation regards what amounts to climate financing based on the EU Taxonomy Regulation and other international taxonomies. The mismatch between the EU climate change standards with other international or national standards (beyond Europe) remains, further making it challenging for projects in developing countries to receive increased targeted climate financing from the European MDBs. The EIB uses the European taxonomy as a natural starting point, albeit, in some limited instances, it may adapt the climate taxonomy to fit the local circumstances such as in the construction of new climate resilient buildings based on local construction practices and materials. In this scenario, it will still maintain the alignment with the joint MDBs approach, but provide climate finance that would not otherwise be available (MDBs 2020). Overall, developing climate action financing, the EIB adheres to the Joint MDBs taxonomy in order to boost its climate financing within the internationally accepted framework. Globally, and in particular reference to developing countries, the EU needs to cooperate at the global level to ensure that its climate taxonomies are well harmonised with those of other international bodies such as the overall United Nations and other major climate financing players.

EIB can also cooperate with other public and private institutions in Europe and abroad to leverage additional

financing for climate action through blended finance platforms and also initiate financial instruments such as special climate bonds to raise additional climate finance for low income countries. However, it faces another bottleneck in directly increasing its climate action financing due to the limitations that may be given by the ELM. EIB external financing is provided by the EU budgetary tools and the EIB business model of implementing the EU external policies is mandated by the European Commission. For the EIB to finance more climate action, it may require that the European Commission mandates it to take on this more development role and accompany this endorsement with the necessary additional budgetary climate action financing under the NDICI programming and any other potential external action support. The EU's programming, hence will need to take into consideration the external climate change needs, and boost financial support for climate action, paying particular attention to the adaptation financing gap while clearly separating the climate finance from the overall development finance.

**The role of other DFIs under the EFSD+: exploiting synergies for EU global climate action**

The EBRD and other EU DFIs also provide climate financing and will be part of the implementation of the EFSD+. The EBRD has set its climate action target to 40% of its investments (Bilal 2019a). The bank invested about €4.6 billion in 2019 (46% of its business volume) in green economy investments and is positioning itself to be more than 50% green by 2025. In its ambition to become mostly a green bank, the EBRD realises and takes into account the impact that the COVID-19 pandemic has had on its countries of operation and will support investments for a green recovery to achieve a low carbon economy and a net zero world by 2050 (EBRD 2020).

Members of European Development Finance Institutions (EDFI), the association of 15 European bilateral development finance institutions, will align the entirety of their financing operations with the Paris Agreement by 2022 and ensure that their portfolio attain net zero emission by 2050, in line with the European Green Deal long term goal. The French Development Agency (AFD) as an implementing agency acting as a development bank has also set strong climate ambitions to abide by the Paris Agreement and aims to raise investments to €5 billion in climate action annually by 2020.

The above commitments by European financiers suggest a high degree of alignment with the European Green Deal long term objective of having a climate neutral Europe by 2050, while supporting the neighbourhood and Africa towards green development and growth. The European open financial architecture provides space to further exploit synergies and the added value of each player. Here, the geographic focus and sectoral expertise of the different EFSD+ implementing partners should also be considered to ensure that, collectively, EU financing responds to local financing needs as well as EU priorities. A recent Report by the High-Level Group of Wise Persons on the European Financial Architecture for Development shows that EU DFIs, particularly members of EDFI have a significant footprint in sub-Saharan Africa, investing about €2.7 billion, in complement of circa €0.9 billion investments by the EIB (Wieser et al. 2019).

A detailed mapping of EU DFIs climate finance could provide a better understanding of the overall European external financing landscape and identify specific financing gaps and opportunities in developing countries, both for mitigation and adaptation. A better understanding of the local climate financing context, including of international and national financiers, could help create a fairer distribution of climate financing even within countries to ensure that investments respond to the needs of the most vulnerable groups and particularly women. Climate mitigation and adaptation strategies in developing countries that exclude women remain weak and may not realise their goals (Ahairwe and Bilal 2020).

**Integration of EU investments in programming will need to be carefully managed**

The 'policy first' approach of the programming process also applies to the EFSD+ and the EAG. This means that programming offers opportunities to bring greater strategic direction to the EU's investments and look for stronger synergies between different EU interventions. The NDICI proposal calls for enhanced cooperation and

coordination between the EIB and the Commission throughout the implementation of the EAG, including during the programming process and in the field. It also mentions that the EIB's dedicated investment windows of an indicative total of €26.7 billion of the EAG will be programmed "in amounts" and should be in line with:

1. (a) EU policy priorities;
2. (b) objectives of the relevant multi-annual indicative programmes (EU programming documents); and
3. (c) EIB policies and procedures (European Council 2020d).

EU external investments will become an increasingly important leg of the EU's external climate action. This is crucial as grants alone will not be able to cover extensive funding needs and are not necessarily the best vehicle for the realisation of a transformative, large-scale climate agenda. The European Commission will therefore need to work closely with the EFSD+ Strategic board to make sure that its climate ambitions are indeed reflected in a balanced and innovative portfolio of actions and that all investments respect the alignment to the Paris Agreement and the 'do no harm' principle (Bilal 2021).

Programming of EU investments for climate action also needs to be well integrated with the policy objectives of the existing EU-external partnerships such as the EU-Africa high level platform on sustainable energy investments, the International platform on sustainable finance, and the EU platform on sustainable finance. Using already existing platforms for cooperation will better address the shared priorities that include accelerating private resource mobilisations to invest in sustainable projects with high impact, while ensuring a harmonised taxonomy and policy dialogue among the EU and its partners. Utilising the prevalent cooperation platforms also provides the EU with the local expertise in partner countries that could promote the alignment of investments with the local context, in line with the OECD DAC blended finance principles (Bilal 2021).

In principle, the EFSD+ allows EU DFIs to access EU budgetary external action financing. It also brings the EU DFIs and MDBs together, some as part of Team Europe, providing them with a framework for stimulating cooperation among themselves but also EU institutions and member states, to harmonise their institutional policies with the EU policies. Programming also provides the DFIs/MDBs with an extensive range of tools and opportunities such as financial instruments for investments, technical assistance, political and policy dialogue that they can tap into in order to strengthen synergies and complementarity among shared mandates. Such a coordinated approach would not only improve coherence of EU action outside Europe; it would also offer wide-ranging expertise on climate financing, project development and external engagement on climate issues that is unparalleled worldwide.

The EU external action also targets countries that have suffered tremendous economic effects of the COVID-19 crisis but with limited fiscal space to finance their recovery projects. Debt levels have risen all across the developing world and the IMF projects LICs alone will require about $200 billion in the next 5 years to recover from the pandemic (IMF 2021). The challenge remains for these countries to prioritise climate action or mainstream it in their recovery programmes without trading it off for other socio-economic and development needs. Through the EAG, the EU will provide macro financial assistance in the form of loans to the countries in need to support their balance sheets and help them deal with COVID-19 economic fallouts, albeit, there is still room for improvement. The EU can better integrate climate action support of the private sector with its moderate assistance of the public sector through other existing initiatives, as well-funded public institutions are more likely to provide a better business climate for private sector development. The European Union and some of its member states are members of the G20 and the Paris Club, which provides an opportunity to adopt a multifaceted approach and boost debt relief efforts to especially the highly indebted countries, supporting their national plans towards a holistic sustainable COVID-19 recovery.

**Closing the adaptation finance gap**

While climate finance is steadily increasing worldwide, it is still a challenge to effectively mobilise financing for climate change adaptation. In 2019, the world's largest MDBs collectively invested just 24% of their total

climate financing to adaptation. European climate financing is also unbalanced and follows a similar path to the global one, with EIB external financing and the EBRD focusing on mitigation, although the European Commission has a relatively extensive adaptation portfolio (Di Ciommo et al. 2018). Only the AfDB invests more than 50% of its climate financing in adaptation as presented in Table 1.

The EIB intends to increase its financing of climate adaptation and climate resilience over the period 2021-2025 (EIB 2020). In addition, both the EIB Climate Bank Roadmap and the EU's 2021 adaptation strategy aspire to 'leave no one behind', which would require more support to adaptation and resilience and a focus on the 'last mile' that is already being affected by climate change. Bridging the gap between policies and financial programmes may take the EIB and the EU in general close to attaining their climate adaptation strategies.

The rationale for greater investment in adaptation is clear: LICs need to deal with the consequences of climate change such as flooding and droughts that have left many people displaced and in need of food assistance (Ahairwe 2019). The difficulty, however, is that many adaptation projects are considered 'unbankable', making them unattractive for DFIs. The EFSD+ and the EAG can improve the attractiveness of these projects by enabling cooperation with national public institutions to de-risk these projects, provide patient capital, provide technical assistance to boost their expertise and improve their feasibility in attracting potential financing.

While policy-makers often see the mitigation-adaptation discussion as an either/or situation, financing climate adaptation does not have to come at the expense of mitigation financing The EU external action financing can increase adaptation financing without trading it off for mitigation (Ahairwe and Bilal 2019). Adaptation and mitigation are interlinked, therefore financing adaptation offers significant returns in sustainable development and poverty eradication, both of which are also a condition for some mitigation efforts to really take off. While the returns of adaptation efforts may sometimes be indirect, their effects can be significant in the medium to long term, and should be considered as a key objective in the EU's climate finance portfolio.

**Targeted financing for low-income countries**

Most of the EU's climate finance goes to MICs (Di Ciommo et al. 2018). For example, the EFSD has invested predominantly in MICs (81%), with a much lower percentage being invested in LICs (19%) (DFI Working Group 2020). Climate funding under the EFSD+ will need to address this issue, and ensure tailored investments, especially in those countries that are most vulnerable to climate change, many of which are fragile contexts, LDCs and LICs.

Low investment in LICs is linked with the unbankable nature of the existing projects brought about by high risk levels that cannot yield either the required development impact or minimum financial return. This is usually the case with green and innovative start-ups that have significant financing needs, but may be projected to have a high risk (have neither financial history nor already visible development impact). Such projects may likely be financed if they are in MICs with at least moderately performing financial sectors.

Another reason is the challenges that some of these countries face in pulling together viable proposals and then navigating the financial and bureaucratic hurdles to make them succeed. Access to finance locally and internationally is generally low in countries which do not offer a relatively stable economic and political environment or where financial markets are underdeveloped. Therefore, innovative climate mitigation and adaptation projects within these environments, while they may be highly relevant, can be very difficult to finance.

Through the EFSD+ and the EAG, the EU has a major role to play to ensure that its resources go where the need is higher and the funding gaps harder to fill. Using financial instruments such as concessional loans, guarantees, blended finance facilities that enable risk sharing may partly address this issue. EU DFIs may also further partner with local national development banks, to utilise local financial expertise while providing technical assistance for startups. Such financial and technical support may help support such projects to

become commercially bankable, and promote sustainable development finance systems.

## Conclusions

The new EU long-term budget reflects the EU's prioritisation of climate action with increased spending targets and a strong commitment to mainstreaming climate change and environmental objectives throughout its domestic and international programmes. How these commitments will be implemented will depend on many different factors. A lot of ambiguity remains around how these broad commitments will be operationalised. At the policy level, further clarification of the EU principles on climate change, including the 'do no harm' principle and the requirement to align investments to the Paris Agreement would help clarify EU ambitions and send a clear signal to partners.

Although climate change is an undeniable priority, the notion of climate justice is not part of the EU's external action. There are some opportunities for the EU to endorse a stronger climate justice-inspired approach. These include supporting just transitions outside of Europe in response to the cascading effects of Europe's domestic transition under the Green Deal. Taking this up explicitly through external financing would help the EU gain credibility as a climate actor. Yet, if not sufficiently backed by effective, visible and substantial support, this could easily backfire. At the moment, however, the notion of climate justice in the EU's external action seems more an afterthought than an integral part of the EU's agenda. More work will need to be done at headquarter and country level to make a strong case for this approach in EU external action.

The more granular decisions that will take place during NDICI programming will have a major significance for climate action outside of the EU. There are several opportunities for putting the EU's money where its mouth is, especially following the policy-first principle and a programming process driven by broad objectives rather than sectors. This approach could also favour climate justice actions. National ownership, broadly understood to encompass state and non-state actors and as a dynamic process, is core for climate action. While in some contexts the EU may find a more conducive environment for collaboration, it may need to step up a gear to work with national champions and selected partners in contexts where the climate agenda does not have enough traction.

Team Europe initiatives offer space for better cooperation between EU institutions, EU member states, and European financial institutions for development. However, the extent to which they will be a game changer for effective EU-wide external climate action remains to be seen. In addition, the success of these initiatives relies on willing and able national partners who see a clear interest in engaging. The extent to which the EU will follow through will also be highly context dependent and will vary in relation to different national circumstances and the ability of the EU itself to articulate priorities that actually match those of national stakeholders.

The long-term patterns of EU financing for climate action will need to change, especially the skewed allocations of EU banks toward mitigation rather than adaptation. The climate crisis calls for urgent action on both fronts and, ideally, actions towards both objectives should be complementary. Data show that both the EIB and the EBRD lag behind on adaptation finance compared to other DFIs globally. While some middle-income countries are major emitters and need financial cooperation, unbalanced allocations towards them also need to be addressed. In line with the EGD's 2050 horizon, a better balance is needed between short-term gains and long-term objectives in the EU's external climate action.

Spending targets can be an encouragement for increased focus on climate change, but they are not a panacea. Past assessments of the Court of Auditors and the European Parliament, have highlighted the need for a more robust monitoring and reporting of EU climate financing that avoids overestimates, gives a reliable account of mainstreaming and is verifiable (European Court of Auditors 2013). MDBs such as the EIB, EBRD, WBG, IsDB, AfDB, ADB and IDBG use a common methodology to track their climate financing (MDBs 2020). The EU may need to harmonise its climate finance taxonomies across the major implementing partners to ensure uniformity in data reporting, and climate financing standard requirements. This is a

technical exercise with high political stakes, given the ambitious spending targets and principles the EU has set for its overall investments in a climate-proof future.

Civil society organisations and other stakeholders will need to engage in active monitoring and analysis of how EU commitments to climate change and related policies land on the ground and how the emerging EU climate policy framework will play out globally. The window is open for at least the next two years to ensure that climate change remains a strategically relevant component of programming and implementation, yet the period to influence wider policy is longer.

Advocacy organisations like the OSEPI and other Open Society Foundations can impact on several of these dynamics, especially by using their network power, regional presence and grant-making ability. Specific avenues for action can include:

- Engaging proactively in the ongoing programming process beyond the established consultation mechanisms through regional and country offices with the aim to Influence the framing and implementation of EU programmes in favour of:
  - sufficient targeting of vulnerable groups;
  - adequate balance between mitigation and adaptation financing;
  - a push for a comprehensive EU engagement with local stakeholders.
- Closely monitoring and engaging with Team Europe initiatives and advocate in particular for the inclusion of vulnerable groups, women and youth as beneficiaries and change agents for climate action.
- Ensuring sustained engagement beyond the programming exercise to ensure through implementation of EU policies, plans and programmes on climate at all levels, including global, regional and country level.
- Expanding engagement beyond the development cooperation actors (DG INTPA and development cooperation sections of delegations) to encompass the EEAS and the political sections of delegations to create momentum for an EU comprehensive action across the full range of EU tools (e.g. financing, cooperation, diplomacy).
- Developing operational proposals for a just transition component in EU external financing, focusing on the EU and EU member states engagement in a limited number of countries that will potentially be hit hardest by EU and global green transition.
- Backing advocacy with high quality, policy relevant and technically savvy analysis, especially on strategic issues such as the through implementation of EU commitments, the EU and member states working together, cohesive action across the different realms of EU external action, the balance between mitigation and adaptation, agri-energy transitions, place-based transitions in developing countries, among others.

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# Endnotes

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[2] A detailed analysis of the various external EGD components is part of the first note of the series (Teevan et al. 2021).

[3] This note is one of a three-part series produced in collaboration with the Open Society European Policy Institute. The series unpacks the evolving EU financial and policy framework for addressing climate and green transition in its external relations, focusing specifically on the (in)direct external effects of the European Green Deal, EU climate finance and international cooperation and the role of climate in the EU-Africa partnership.

[4] A recent agreement proposes that each national plan from European member states under the NGEU's Recovery and Resilience Facility meet a 37% target (European Council 2020c).

[5] This includes official development assistance as well as other official flows. The EIB and EBRD follow the Multilateral Development Banks Joint Approach. More information is available on the OECD DAC External Development Finance Statistics webpage.

[6] With the exclusion of the Instrument for Pre-Accession Assistance, humanitarian aid, the Common Foreign and Security Policy, the European Peace Facility, the Solidarity and Emergency Aid Reserve and other minor instruments.

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