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Boosting EU climate finance: MITIGATE MORE WITHOUT NEGLECTING ADAPTATION IN POORER COUNTRIES

CLIMATE CHANGE

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As the 25th Conference of the Parties (COP25) in Madrid calls for the full operationalisation of the Paris Agreement, Europe is committing to green its policies both within and beyond the European Union (EU). Boosting green finance will be critical.

European top financial institutions such as the European Central Bank (ECB), the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), which are in a position to advance the European agenda, are joining the battle to curb climate change. This decision follows calls for a Climate Bank at the European level and the recommendation by the High-Level Group of Wise Persons that the EU should adopt a common approach to its external financial architecture and establish a single entity, the so-called European Climate and Sustainable Development Bank.

Although global climate financing has increased by 60% over the period 2013-2018, this is not enough. Besides, more resources should be dedicated to climate adaptation, which has been neglected, in particular by European finance institutions. Multilateral Development Banks (MDBs), including EIB and EBRD, allocated only 30% of their 2018 climate financing to adaptation. EBRD and EIB allocated as low as 11.8% and 7.6% respectively to adaptation in developing countries.

The consequences of climate change, including droughts, floods, plummeting biodiversity and the loss of human lives, are undermining low-income and fragile countries' development prospects. EU efforts to boost its climate action and finance should encompass not only the vital mitigation endeavour, but also greater attention to climate adaptation, as a means to foster climate justice and to achieve the SDGs also in low-income countries, and in Africa in particular. The new European Green Deal will have to live up to this challenge.

1. Introduction

As the COP25 conference in Madrid calls for full operationalisation of the Paris Agreement on climate change,¹ Europe seems committed to scale up its actions and green its policies both within the European Union (EU) and beyond (von der Leyen, 2019a,b).² Ursula von der Leyen, the new European Commission president, is launching the European Green Deal to help make Europe a climate-neutral continent by 2050 while supporting the least developed countries via the Transition Fund (von der Leyen, 2019b).³ Similarly, the European Parliament has declared a climate and environmental emergency,⁴ a symbolic yet significant step calling for a 55% cut in greenhouse gas emissions by 2030 and a climate-neutral Europe by 2050.

2. Greening EU finance

Climate finance is a crucial enabler to achieving the Paris Agreement (CPI 2019). Indeed, the EU is increasingly greening its finance for sustainable growth.⁵ The Union's first step has been to define what 'greening' means in practice, based on a common EU taxonomy to sustainable activities.⁶ A common taxonomy has now been agreed upon by the European Parliament representatives and the Finnish Council Presidency.⁷ This consensus should help tackle the present high greenwashing tendencies (Zhang, 2019). The European Commission is also considering the controversial move of easing bank rules on capital charges for green finance,⁸ and possibly, take on the France proposal, which requires that all EU companies abide by common environmental reporting standards.⁹

Europe's biggest financial institutions, the European Central Bank (ECB), European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), have joined the battle to advance the European agenda in curbing climate change. The new president of the ECB, Christine Lagarde, has echoed to a recent leading personalities' call¹⁰ by awakening the bank to make climate change its critical mission.¹¹

Following the French president Emmanuel Macron's proposal for a European climate bank, which was endorsed by Ursula von der Leyen, the EIB has just launched an ambitious climate strategy and adopted a new energy lending policy (EIB 2019a,b).¹² The EU bank notably commits to:

- align all its financing with the Paris Agreement goals by the end of 2020,
- unlock €1 trillion for climate action and environmental sustainable investment by 2030, and
- phase out financing of fossil fuel unabated energy projects by the start of 2022.
- increase its green finance to reach 50% of its operations in 2025.

¹ <https://unfccc.int/cop25>

² [New EU chief flags climate policy as Europe's 'new growth strategy'](#), Euractiv, 27 November 2019.

³ [Media briefing on European Green Deal: early test of Von der Leyen's commitment to the environment](#). European Environmental Bureau. 2 December 2019.

⁴ <https://www.europarl.europa.eu/news/en/press-room/20191121IPR67110/the-european-parliament-declares-climate-emergency>

⁵ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/green-finance_en

⁶ [EU taxonomy for sustainable activities](#). European Commission.

⁷ [EU reaches milestone by agreeing on green criteria for finance](#), Euractiv, 5 December 2019.

⁸ [Brussels eyes easing bank rules to spur green lending](#), Financial Times, 27 November 2019.

⁹ [France seeks compulsory green reporting standards for EU companies](#), Financial Times, 29 November 2019.

¹⁰ [The ECB must act now on climate change](#), Open letter to Christine Lagarde. 27 November 2019.

¹¹ [Christine Lagarde wants key role for climate change in ECB review](#), Financial Times, 27 November 2019.

¹² [Macron's Dream of a Climate Bank Gets Boost from New EU Leader](#), Bloomberg, 12 July 2019.

The EBRD is fostering lower carbon and resilient economies through its green economy transition approach¹³ and respective initiatives like the sustainable energy initiative¹⁴ and the EBRD green cities¹⁵ (EBRD 2019a). With already 36% of its annual volume of investment being green in 2018, the EBRD should seek to go beyond its 40% green finance target set for 2020.

European national promotional and development banks are also increasingly greening their operations. For instance, the Dutch Entrepreneurial Development Bank FMO has committed to have at least 32% of its investment to be green by 2020,¹⁶ and has set up new initiatives¹⁷ such as the Dutch Fund for Climate and Development (DFCD) launched this year.¹⁸ The German *Kreditanstalt für Wiederaufbau* (KfW) has a high 58% of its financial commitments already green (KfW 2019a,b).¹⁹ While France *Agence Française de Développement* (AFD) has committed to 50% green finance and to make 100% of its operations compatible with the Paris Agreement. AFD is also the chair of the International Development Finance Club (IDFC), a group of 26 national and regional development banks (including other European ones such as KfW and Cassa depositi e prestiti CDP), which has announced at the UN Climate Action Summit in September 2019 its commitment to jointly provide at least US\$1 trillion of climate finance by 2025 (IDFC 2019). The increased commitment of development banks, in Europe and beyond, is critical to mobilise private finance for climate and environmental objectives, as well as sustainable development (Box 1).

Box 1. Green, brown and Paris Agreement aligned finance

While financing the transition towards low carbon, climate-resilient economies is imperative, moving from brown to green finance does not mean that all finance that is not green is therefore brown. This is worth stressing in pursuing the 2030 Agenda on sustainable development, as financing issues such as health, education and gender does not qualify as green finance, yet does not imply it is brown, i.e. contributes to global warming or damages the environment. By the same token, compatibility with the Paris Agreement does not mean that finance is green, i.e. contributes to climate mitigation and adaptation and protection of the environment. It follows that while financial institutions should increase the share of their green finance, for a positive climate agenda, they should not seek to devote all their resources to green investment only, but should ensure that none of their development investment undermines the objectives of the Paris Agreement.

In practice, the transition from brown to green finance and alignment with the Paris Agreement is a complex issue, raising many methodological, implementation and transparency challenges (Clark et al. 2019, Cochran and Pauthier 2019, Climate Transparency 2017 & 2019, FMO 2019, Larsen et al. 2018, OECD 2019).

Indeed, efforts to green finance for greater sustainability ultimately rests on bringing along the private sector. The integration of the environmental, social and corporate governance (ESG) factors in business investment is becoming a benchmark.²⁰ But more needs to be done. Large investors such as pension funds and

¹³ <https://www.ebrd.com/what-we-do/get.html>

¹⁴ <https://www.ebrd.com/what-we-do/sectors-and-topics/sustainable-energy-initiative.html>

¹⁵ <https://www.ebrd.com/what-we-do/get.html>

¹⁶ <https://www.fmo.nl/news-detail/c09d9194-33bb-45d0-b68c-be043ea183fc/p-plus-special-on-fmo-s-innovative-climate-finance-funds>

¹⁷ <https://www.fmo.nl/climate-action>

¹⁸ <https://thedefcd.com/> and FMO: [Dutch Fund for Climate and Development open for business](#), Financial Investigator, 15 November 2019. For a broader overview of the Dutch public actions to mobilise private climate finance, see Trinomics (2019).

¹⁹ www.kfw-entwicklungsbank.de/International-financing/KfW-Development-Bank/Topics/Climate/

²⁰ [ESG accelerates into the investment mainstream](#), Financial Times, 20 May 2019; [Is Sustainable Investing Moving Into the Mainstream?](#), UBS in Harvard Business Review, 15 November 2019.

insurers,²¹ responsible hedge funds such as TCI,²² and sovereign wealth funds like that of Norway,²³ are also playing a critical role in enhancing the environmental accountability of companies. Leading private actors can have a catalyst effect in triggering green finance. This is the case for instance of the ones assembled under the Climate Finance Leadership Initiative (CFLI) by Michael Bloomberg at the behest of UN Secretary-General António Guterres (CFLI 2019), which has also recently established a partnership with the Association of European Development Finance Institutions (EDFI).²⁴ Another example is the Institutional Investors Group on Climate Change (IIGCC), a group of close to 200 European asset owners and managers - including leading institutional investors - committed to sustainable and responsible investment, which recently called on EU leaders to aim high in new EU climate change ambitions and set up an EU net-zero emission target by 2050.²⁵

Yet, commercial banks are too slow in greening their business. Although the financial sector is increasingly adopting some baseline principles, such as the ESG criteria and guidelines by the Taskforce on Climate-related Financial Disclosures (TCFD)²⁶, they do so at too slow a pace. Worse, even when adopted, climate and environmental principles are too often not translated into practice, with banks not significantly altering their portfolio towards decarbonisation and environment-friendly investment, as pointed out in a recent survey (Boston Common, 2019). Leading French banks have even been accused of having a huge carbon-footprint (Oxfam 2019). Most private sector actors still fail to realise the urgency to tackle climate change and adapt their business accordingly. They fail to properly assess the exposure of their own business to climate risks, and to appreciate the fighting climate change and promoting green economy is good business as well (Scott 2019, Global Commission on the Economy and Climate 2018).

All this comes amid the recommendation by the High-Level Group of Wise Persons that the EU should adopt a more coherent approach to its financial architecture for development (European Council 2019; Bilal 2019). The Wise Persons Group's counsel suggests that the European Council to fully integrate climate change together with biodiversity, and establish a European Climate and Sustainable Development Bank (as an *offspring* of the EIB, or through the EBRD) to handle development financial activities outside the EU. Their urge positions well with the next long-term EU budget, which also seeks alignment with the Paris Agreement and ambitious climate targets for EU development finance (ETTG 2019).

3. Boosting climate finance, without neglecting adaptation

Global climate finance has increased by 60% since 2013, reaching over half a trillion US\$ in 2018; however, it still falls short of the estimated annual US\$1.6 to US\$3.8 trillion needed to achieve the 1.5°C global warming target (CPI 2019; IPCC 2018). A climate emergency requires all players to do more, justifying the new Commission president's European Green Deal approach.

²¹ [Pension funds and insurers pledge climate action at UN summit](#), Reuters, 23 September 2019.

²² [Hedge fund TCI vows to punish directors over climate change](#), Financial Times, 1 December 2019.

²³ [Norway's sovereign wealth fund backs away from fossil fuels](#), Deutsche Welle, 10 July 2019.

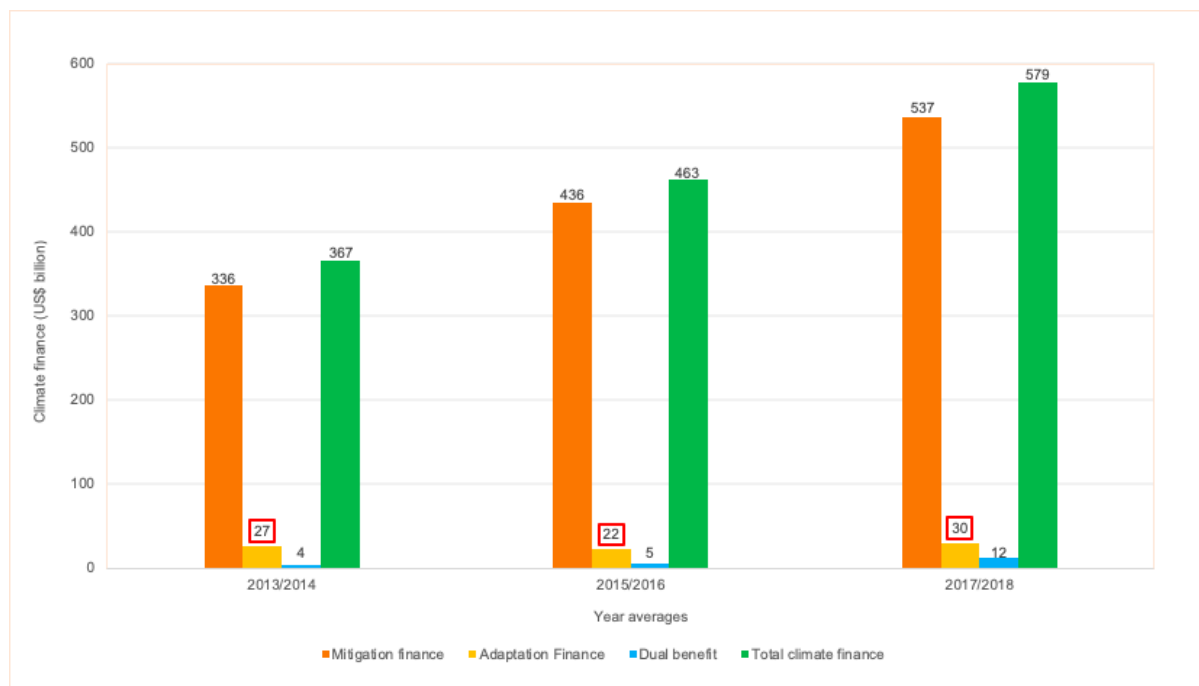
²⁴ [EDFI partners with the Climate Finance Leadership Initiative to drive climate finance in emerging markets](#), EDFI, 24 September 2019.

²⁵ <https://www.iigcc.org/news/major-european-investors-call-on-eu-leaders-to-sign-off-climate-neutral-target/>

²⁶ <https://www.tcfhub.org/>

While climate mitigation financing is capital, adaptation finance remains the orphan of climate finance, as illustrated in Figure 1. On average adaptation finance has accounted for about 5% of climate finance since 2015/2016 (CPI 2019, 2018). Though it rose to US\$30 billion in 2017/2018, financing for adaptation still falls far from the estimated US\$230 billion annual requirement. Climate mitigation finance is vital but climate adaptation should not be neglected.

Figure 1. Climate finance 2013-2018 (two-year averages; US\$ billion)

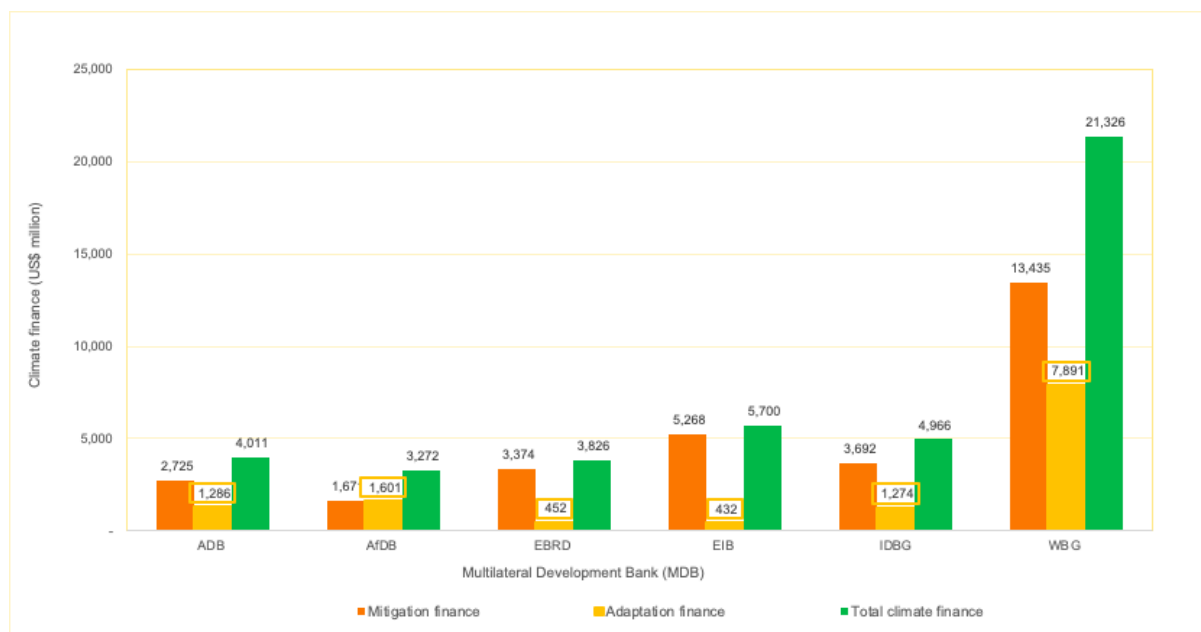


Source: Compiled by the authors using CPI (2019, 2018, 2016) data

Climate adaptation relies solely on public finance, nearly 80% of which comes from multilateral development banks (MDBs) and development finance institutions (DFIs). But more should be done, particularly by Europeans. In 2018 alone, only 30% of the total MDBs' climate finance was invested in adaptation projects (MDBs 2019). The proportion of adaptation finance to total climate finance was highest with the African Development Bank (AfDB) at 48.9%, followed by the World Bank Group (WBG) at 37.0%, and lowest –even in value terms– with the EBRD and the EIB at 11.8% and 7.6% respectively, as shown in Figure 2.²⁷ This weakens the Paris Agreement pledge, which advocates for a balance between mitigation and adaptation.

²⁷ For the sake of comparison, KfW adaptation finance amounted to €1342 million in 2018 and accounted for 26% of its total climate and environment finance (KfW 2019b).

Figure 2: MDBs adaptation finance as a proportion of total climate finance (2018; US\$ million)



Source: compiled by authors using MDBs (2019) data

Blended finance has been identified as a means to leverage more private finance from developing countries. But it has failed to do so in any significant proportion in the case of climate adaptation. Blended finance for adaptation was a mere 3% of overall blended finance in 2016/2017 (OECD 2019).

Paradoxically, while the African continent features among the least emitters of greenhouse gas emissions, it remains the continent most vulnerable to climate change (Global Carbon Project 2019, IPCC 2018). Climate adaptation finance is essential to African developing countries that are already hard hit by climate change. The occurring droughts, floods and biodiversity losses make climate change a present reality whose negative impacts ought to be addressed if these countries are to achieve sound economic growth. The food and agriculture sectors are particularly vulnerable to climate change, in turn affecting disproportionately poor and rural communities, making adaptation finance for these issues even more critical (Tietjen et al. 2019).

4. Costly consequences of climate change for developing countries

Climate change consequences cause additional and high economic costs which developing countries would otherwise not have incurred. Indeed, 2017 was the costliest year on record, throughout which the economic costs of the climate change consequences were valued at US\$330 billion (UNEP 2018). UNEP (2018) estimates the financing needs of adaptation in 50 developing countries at US\$8500 billion for the period 2020-2050, with annual average financing costs projected to be above US\$50 billion. The costs of climate change will also further increase the debt of developing countries by an estimated US\$146 billion for the period 2019-2028 (Buhr et al. 2018).

If developing countries are to achieve the Sustainable Development Goals (SDGs), addressing the consequences of climate change is crucial. Promoting finance for adaptation would reduce the climate change burden of these countries. Most climate adaptation finance should indeed be aimed at the least developed countries and the most vulnerable groups of people in these nations (Bird et al. 2017). But in reality, the vast majority of climate finance goes to middle-income countries (MDBs 2019, Dejgaard and

Appelt 2018). DFIs, particularly the European ones, can play a vital role in “leaving no one behind” by tapping into the under-invested adaptation projects in least developed countries, leveraging more private finance in particular in agriculture and reaching out to more vulnerable and remote communities (Tietjen et al. 2019).

Supporting vulnerable countries to adapt to climate change will yield sustainable development and eradicate poverty (IPCC 2018). It will also reduce the risk of climate change, making some adaptation financing options sure ways to ‘kill two birds with one stone’. However, funds dedicated for adaptation are more prone to the risk of greenwashing (Oxfam 2018). Therefore, there is a need for proper earmarking and accountability mechanisms, especially in the least developed and fragile countries (Micale et al. 2018).

EU efforts to boost its climate action and financing in low-income countries of Africa should encompass not only the vital mitigation endeavour, but also greater attention to climate adaptation, as a means to foster climate justice²⁸ and to achieve the SDGs. The new European Green Deal will have to live up to this challenge.

²⁸ <https://www.un.org/sustainabledevelopment/blog/2019/05/climate-justice/>

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