BRIEFING
Requested by the BUDG and CONT committees

European Parliament

Background information for the BUDG-CONT joint workshop on **'The Role of the EU Budget in International Climate Finance'**

The Committees on Budget (BUDG) and Budgetary Control (CONT) held a workshop on the role of the EU budget in international climate finance with invitation to Members of the Committee on Environment, Public Health and Food Safety (ENVI). The workshop covered a series of important questions regarding the financial instruments needed to reach the environmental goals set out in the Paris Agreement, of which the European Union (EU) and all its Member States (MS) are signatories. More specifically, the question was raised as to how much has been committed so far financially and how much of this is the EU's contribution. The key challenges in answering these questions are brought to light in the following sections. This briefing provides background information for Members of BUDG, CONT and ENVI about what is known to date about international climate finance and the role of the EU budget in this regard.

1. Introduction

Climate change and environmental degradation are two of the biggest global challenges of our time and represent an existential threat to Europe and the world. The EU and all its MS have signed the Paris Agreement (2015) which aims to limit global warming to well below 2°C, and preferably to 1.5°C, compared to pre-industrial levels. The European Green Deal functions as the EU's strategic roadmap of policy initiatives, which aims to support the path to a green transition, with climate neutrality for the European continent as the ultimate goal by 2050. To achieve these goals, investments from the public and private sectors are a necessity both within Europe and in the rest of the world.

According to the European Environment Agency, 'climate finance refers to investments that support significant reductions in greenhouse gas emissions, and to financial measures that help adapt to the current and future impacts of a changing climate'. In this light, climate finance refers to local, national, and transnational mechanisms of financing with the goal of supporting both mitigation and adaptation actions. While climate change mitigation specifically refers to efforts that seek to reduce or prevent the emission of greenhouse gases, adaptation to climate change points out the actions taken to prepare for and adjust to both the current and future effects of the changing climate. Climate finance is a necessity in both fields.

A call for financial assistance from Parties with greater financial resources in the developed world to those that are less endowed and more vulnerable is backed by the United Nations Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol and the Paris Agreement. Country-specific climate action plans that specify national strategies to cut emissions and adapt to climate impacts are addressed in Nationally Determined Contributions (NDCs) that are renewed every five years. For effective NDC implementation, an unprecedented amount of climate finance needs to be mobilised.

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PE 742.134 - January 2023

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2. How much is actually needed?

Methodological challenges

A wide range of international organisations and climate experts have attempted to calculate the amount of international climate finance which is needed overall to reach the Paris Agreement goals. However, due to the highly complex character of the climate crisis and the significant range of policy fields that it touches upon, estimates vary widely. Generally, financial spending is split among mitigation and adaption actions which in turn are interrelated. While 'mitigation reduces all impacts (positive and negative) of climate change [by reducing the sources or enhancing the sinks of greenhouse gases] and thus reduces the climate challenge, adaptation is selective; it can take advantage of positive impacts and reduce negative ones'[1].

When looking at the international climate finance estimations needed to reach the Paris Agreement goals globally, one has to be aware of the inter-relationships between both terms. As outlined by the Intergovernmental Panel on Climate Change (IPCC), the relationship between adaptation and mitigation knows various forms. Adaptation action can have consequences for mitigation – and the other way around – while certain policy decisions can also include trade-offs or synergies between the two. The intrinsically complicated relationship between both types of actions makes it hard to calculate the real effects of climate spending on climate change. Additional key challenges – among many others – in assessing the cumulative costs of international climate finance relate to the effectiveness of financial spending on climate actions, the uncertainty associated with alternative emission scenarios, the environmental objectives set and the definitions used. The methodological limitations allow for the sketching of many different scenarios on how to finance the road to a net-zero transition and how much this will end up costing.

Estimation attempts

Ahead of the Sharm el-Sheikh COP27 UN Climate Change Conference in November 2022, the UN Environment Programme (UNEP) published two annual reports focusing on both ends of the scale. A differentiation can be made here between the financial needs for climate adaptation and mitigation. The Adaptation Gap Report 2022 (AGR) states that the adaptation finance gap in developing countries is widening rapidly as international support is not sufficiently aligned with the needs of 76 developing countries as expressed in their most recent NDCs. Although actions contributing to climate adaptation globally have been increasing significantly over time, estimated adaptation needs are currently between five to ten times higher than international adaptation flows. Based on data gathered from various sources, the AGR estimates that the annual cost of adaptation in developing countries could be between USD 160 billion and 350 billion by 2030. 'With increasing levels of climate change [in case the Paris Agreement goals are not sufficiently met in time], this annual cost was projected to increase to between USD 315 billion and USD 565 billion by 2050'[2]. With the cost of capital generally being even higher in emerging markets, developing countries rely almost entirely on their developed counterparts to finance this climate action gap.

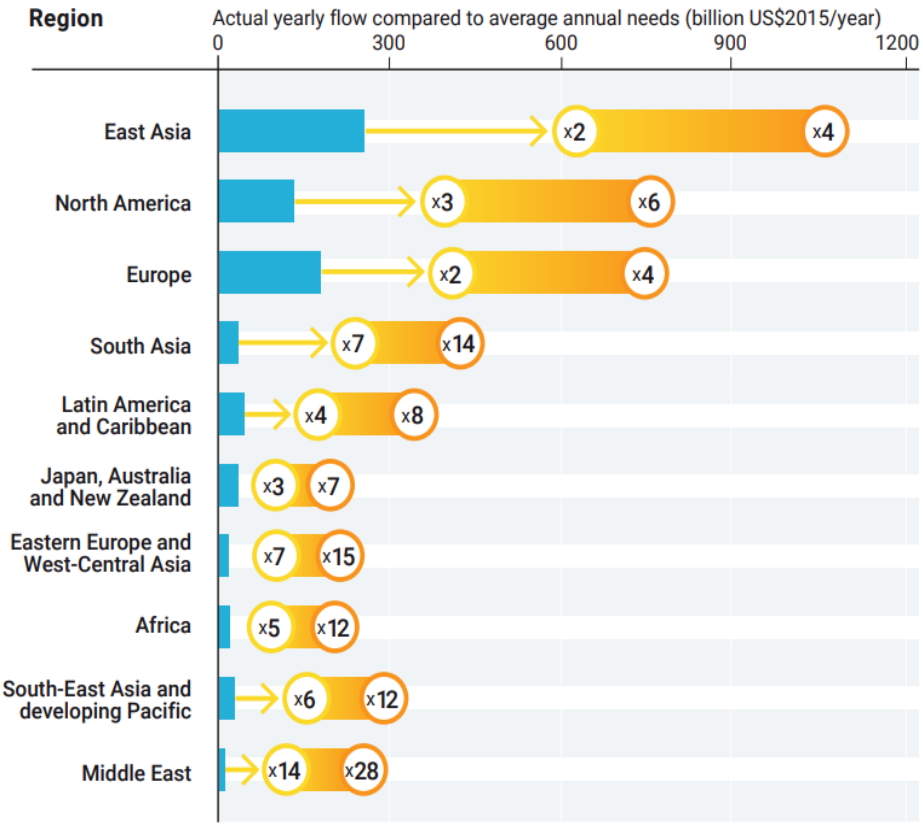
The Emissions Gap Report 2022 (EGR) by the UNEP published in the same month states that even if all objectives of the current NDCs of participating countries are successfully implemented, the planet would still end up with an increase of 2.6°C compared to pre-industrial levels, with the current state of policies in place even pointing at a 2.8°C rise. There is a crucial gap in national commitments and the actions necessary to reach the Paris Agreement goals. In particular, a rapid increase in investments in low-carbon assets – renewable energy sources – would be a necessity to support climate mitigation in the long run. While climate-related investments in mitigation rose significantly to about USD 571 billion per year in 2019-2020,

[1] Klein, R.J.T., S. Huq, F. Denton, T.E. Downing, R.G. Richels, J.B. Robinson, F.L. Toth, 2007: Inter-relationships between adaptation and mitigation. Climate Change 2007: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, M.L. Parry, O.F. Canziani, J.P. Palutikof, P.J. van der Linden and C.E. Hanson, Eds., Cambridge University Press, Cambridge, UK, 750.

[2] United Nations Environment Programme (2022). Adaptation Gap Report 2022: Too Little, Too Slow – Climate adaptation failure puts world at risk. Nairobi. https://www.unep.org/adaptation-gap-report-2022.

the IPCC has predicted that an increase by a factor of 3 to 6 is needed on average globally [3]. Based on research presented by the IPCC, Figure 1 shows the uneven distribution of climate investment needed per region averaged until 2030, with 2015 used as the base year[4]. It highlights the UNFCCC's call for financial assistance in terms of cross-border investment from Parties with greater financial resources in the developed world to those that are less endowed and more vulnerable.

Figure 1: Finance flows and mitigation investment needs per region (averaged until 2030)



Source: United Nations Environment Programme (2022). Emissions Gap Report 2022: The Closing Window – Climate crisis calls for rapid transformation of societies. Nairobi. https://www.unep.org/emissions-gap-report-2022, p. 66.

Using a different methodology, the report (October 2022) published by Climate Policy Initiative (CPI) states that at least USD 4.3 trillion in annual finance flows – mitigation and adaptation costs combined – by 2030 is needed overall to avoid the worst impacts of climate change. This, compared to preliminary estimates suggesting a total of finance flows in 2021 amounting to USD 850-940 billion, results in a recommendation of at least a factor of 4 regarding climate finance by 2030.

Separate research (2018) carried out by the Organisation for Economic Co-operation and Development (OECD) even estimates that an amount of USD 6.9 trillion is required annually up to 2030 to reach the current climate and development objectives, highlighting that annual investment in energy efficiency and renewable energy particularly would need to increase by a factor of 5 by 2050. Although all mentioned reports are based on different research using various types of methodology, the common conclusion is that there is a significant gap in international climate finance if the Paris Agreement goals are to be met.

[3] United Nations Environment Programme (2022). Emissions Gap Report 2022: The Closing Window – Climate crisis calls for rapid transformation of societies. Nairobi. https://www.unep.org/emissions-gap-report-2022.

[4] M. Pathak, R. Slade, P.R. Shukla, J. Skea, R. Pichs-Madruga, D. Ürge-Vorsatz (2022). Technical Summary. In: Climate Change 2022: Mitigation of Climate Change. Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change [P.R. Shukla, J. Skea, R. Slade, A. Al Khourdajie, R. van Diemen, D. McCollum, M. Pathak, S. Some, P. Vyas, R. Fradera, M. Belkacemi, A. Hasija, G. Lisboa, S. Luz, J. Malley, (eds.)]. Cambridge University Press, Cambridge, UK and New York, NY, USA. doi: 10.1017/9781009157926.002.

3. How much has been pledged or committed so far?

Tracking challenges

Throughout the research, a number of tracking challenges have been identified, which include but are not limited to the lack of data available on the private sector and some public sector flows, the disparity of sources, and the intertwining of public and private flows. Public international climate finance is making progress in its reporting methodology, enabling providers to understand climate investments better. However, the same level of reporting expertise is lacking in the private sector, which leads to data gaps. Another challenge is to get a complete picture of climate finance through individual country reports due to disparate sources. Finally, categorising the different financial flows (public/private and international/domestic) can also be difficult.

Climate finance between 2011 and 2020

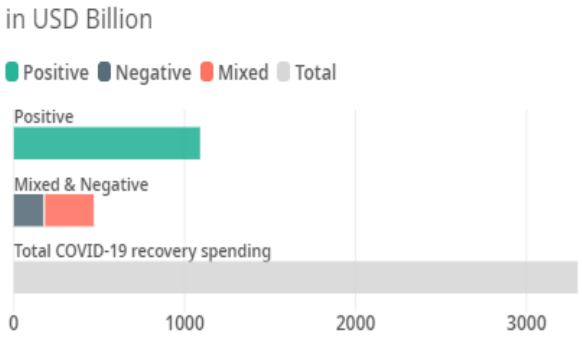
According to the recent CPI report, global climate finance has almost doubled over the past decade, with an average of USD 480 billion per year or a cumulative USD 4.8 trillion. Mitigation financing has grown by a 6% cumulative average annual growth rate (CAGR), while adaptation funding has been increasing rapidly, achieving an overall 16.7% CAGR. However, current rates of increase are not sufficient to achieve a 1.5°C global warming scenario, even if global climate finance has grown by 7% CAGR. Geographically, the largest share of climate finance (76%) was generated and spent at national level, i.e. primarily in East Asia and the Pacific (mainly led by China), North America and Western Europe. Annual climate flows averaged USD 653 billion in 2019-2020, 15% higher in comparison to 2017-2018[5].

Additionally, at COP16 in 2010, the Green Climate Fund (GCF) was established and subsequently designated as an operating entity of the financial mechanism. It is a financial mechanism established by the UNFCCC, which aims to facilitate the provision of climate finance and serves the Kyoto Protocol and the Paris Agreement. By October 2019, a total of 27 states – of which a vast majority are EU MS – had pledged to replenish the fund with an additional USD 9.78 billion equivalent for the four years that followed.

Green recovery measures

Following the COVID-19 pandemic, the OECD created a platform known as the Green Recovery Database, which measures economic recovery efforts with environmental impacts, ranking them as positive, negative or 'mixed'.

According to this database, the budget for environmentally positive measures increased from USD 677 billion to USD 1 090 billion, which is 33% of total stimulus spending announced since the beginning of the crisis.



Source: OECD Green Recovery Database (2022)

The USD 100 billion goal

At the UNFCCC's 15th Conference of the Parties (COP15) in Copenhagen in 2009, developed countries committed to a collective target of mobilising USD 100 billion annually by 2020 for climate action in developing countries. This target was recognised in the Cancun Agreements adopted at COP16. It was then reaffirmed and extended to 2025 at COP21 in Paris. In 2020, the initial target year under the UNFCCC, the total climate finance provided and mobilised by developed countries for developing countries amounted to USD 83.3 billion. While representing an increase of 4% from 2019, this means that the collective level of developed-country climate finance remained USD 16.7 billion short of the goal.

[5] Climate Policy Initiative [B.Naran, J.Connolly, P.Rosane, D.Wignarajah, E.Wakaba, B.Buchner]. 2022. Global Landscape of Climate Finance: A Decade of Data 2011-2020.

Climate finance components

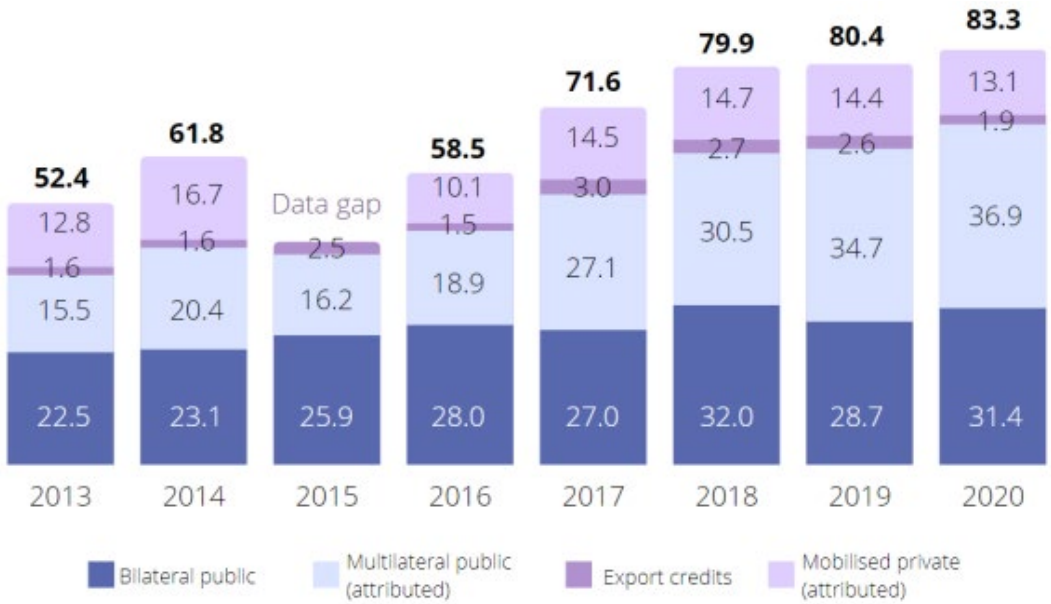
The OECD monitors climate finance provided and mobilised by developed countries for climate action in developing countries based on four distinct components:

- **Bilateral public climate finance**: public climate finance commitments (excluding export credits) by developed countries for developing countries;
- **Multilateral public climate finance attributed to developed countries**: climate finance provided by multilateral development banks (MDBs) and multilateral climate funds to developing countries;
- **Climate-related officially supported export credits**: financial support extended by developed countries' export credit agencies for climate-related projects in developing countries;
- **Private finance mobilised by bilateral and multilateral public climate finance and attributed to developed countries**: proportion of finance from private sources mobilised by bilateral and multilateral public finance interventions in support of climate activities in developing countries which can be attributed to developed countries.

Bilateral and multilateral public climate finance represented the largest share of the total. Between 2013 and 2020, it increased from USD 38 billion to USD 68.3 billion, i.e. by 80%. It should also be noted that since 2015 it has constantly increased year on year. In particular, from 2013 to 2020, multilateral public climate finance attributable to developed countries increased by 138%, compared to a 40% increase in bilateral public climate finance for the same period[6].

As for climate-related export credits, between 2013 and 2020, they increased by 19%, but their proportion of the total remains modest. Mobilised private climate finance increased by almost 30% between 2016 and 2020.

Figure 2. Climate finance provided and mobilised in 2013-2020 (USD billion)



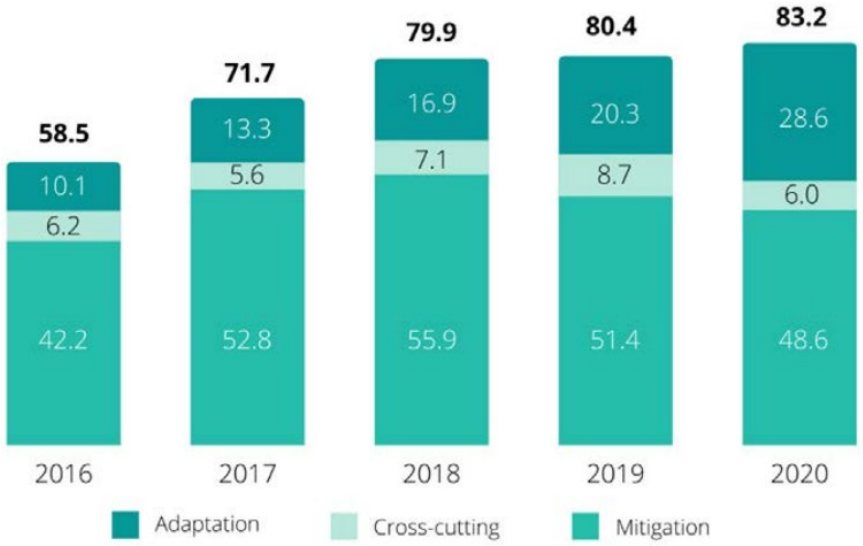
Source: OECD, Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020, https://doi.org/10.1787/d28f963c-en

[6] OECD (2022), Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020, Climate Finance and the USD 100 Billion Goal, OECD Publishing, Paris, https://doi.org/10.1787/d28f963c-en

Thematic split of climate finance

Both mitigation and adaptation funding provided and mobilised by developed countries increased in absolute terms between 2016 and 2020. However, over the period 2019-2020, while adaptation funding increased by USD 8.3 billion (41%), mitigation funding decreased by USD 2.8 billion (5%). In 2020, mitigation represented 58% of total climate finance provided and mobilised (Figure 2).

Figure 3. Thematic split of climate finance provided and mobilised in 2016-2020 (USD billion)



Source: OECD, Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020, https://doi.org/10.1787/d28f963c-en

4. How much is the EU's contribution?

The European Union and its MS are strongly committed to supporting the Paris Agreement and limiting global warming. In this context, the EU countries are committed under the European Climate Law to a reduction of greenhouse gas emissions by at least 55% by 2030, supporting the objective to become the first climate-neutral bloc by 2050.

EU budgetary expenditure and instruments

According to the Commission, 20% of the total EU budget of the multiannual financial framework (MFF) 2014-2020 (totalling EUR 908.40 billion in payments) was spent on climate-related actions. This amounts to a total of EUR 216 billion of spending on climate-relevant measures under the previous MFF.

The current MFF combines EUR 1 074.3 billion (MFF) and an additional EUR 750 billion (NGEU recovery instrument) for a total budget of EUR 1.8 trillion for the years 2021-2027. An overall climate target of 30% applies to the total amount of expenditure from the EU budget under the current MFF and 35% for the Neighbourhood, Development and International Cooperation Instrument (NDICI) which forms the main financial pillar of the Union's external action. The EU continues its commitment towards the jointly set goal of mobilising USD 100 billion per year until 2025 in order to contribute to climate action support regarding developing economies. The EU is financing the transition to climate neutrality through various instruments in the current EU budget. Table 1 lists the most prominent instruments in the MFF 2021-2027.

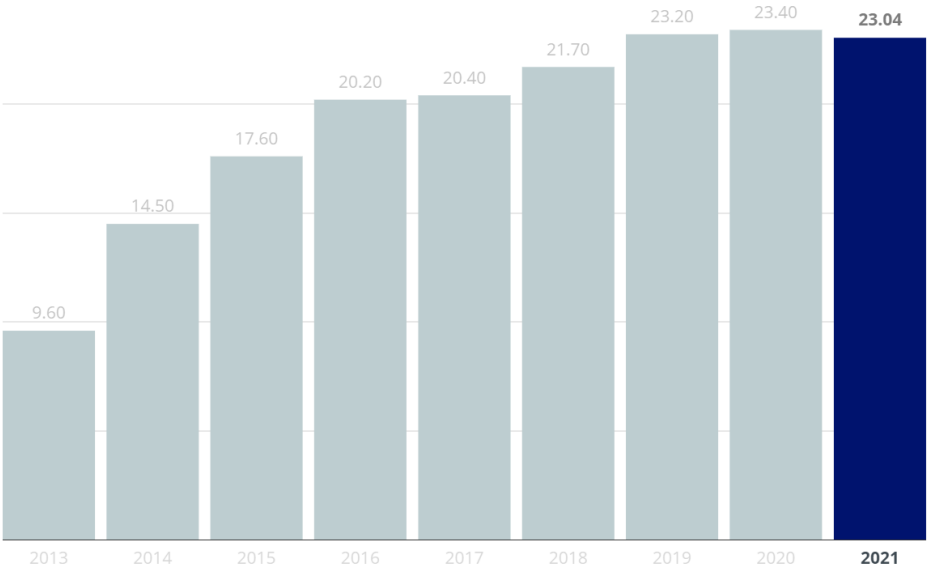
Table 1. EU budgetary instruments for climate finance

Programme	Description	MFF 2021-2027 funding (EUR)
Just Transition Mechanism	Aims to address the socioeconomic impact of the transition to a low-carbon economy and environmental legacy problems to harness new sustainable economic development opportunities for the places and communities most affected.	65-75 billion
Modernisation Fund	Intended to support 10 MS in meeting 2030 energy targets by contributing to the modernisation of energy systems and improving energy efficiency.	14 billion
Horizon Europe	The EU's main funding programme for research and innovation, tackling climate change and helping to achieve the UN's Sustainable Development Goals.	95.5 billion
Innovation fund	One of the world's largest funding programmes for the demonstration of innovative low-carbon technologies that contribute to the reduction of greenhouse gases.	10 billion
LIFE Programme for the environment and climate action	One of the cornerstones of European environment and climate funding, contributing to the implementation, updating and development of EU environmental and climate policy and legislation by co-funding projects with European added value.	5.4 billion

Beyond the EU

The EU and its MS and the European Investment Bank (EIB) are together the largest contributor of public climate finance to developing economies, providing around EUR 23.4 billion overall in the year 2020 alone. The Commission's contribution to developing economies was EUR 2.6 billion in 2020, the majority of which tackles climate adaptation activities. Worldwide, the EU is one of the top providers of development assistance, into which climate action is progressively integrated. The infographic in Figure 4 illustrates that funds raised to support developing countries to mitigate and adapt to the impact of climate change have more than doubled since last decade.

Figure 4. Europe's contribution to climate finance (in EUR billion) since 2013



Figures include sources from public budgets and development financial institutions of the EU, its member states (including the UK) and the European Investment Bank.

Source: European Council, https://www.consilium.europa.eu/en/infographics/climate-finance/.

Supporting public and private climate finance

Although a significant and increasing share of the EU's budget is committed to climate action, there is still a need for countries to attract additional public and private financing for the transition to a climate-friendly economy. According to data from the World Resource Institute, USD 76 billion globally was invested in unsustainable, polluting activities and fossil fuels by public and private agencies in the year 2020 alone. At the same time, significant shortages remained regarding the USD 100 billion promises made in the Paris Agreement. According to the Commission, 'international climate finance should be used as a lever to incentivise climate-resilient and low-carbon investments, complementing domestic resources in developing countries'. The EU set an important example by establishing a common language and a clear definition of what is 'sustainable' through the EU Taxonomy and providing guidance in this regard.

EU Taxonomy

Regulation (EU) 2020/852 represents a key step towards the Union's objective to achieve climate neutrality by 2050 by establishing a framework to facilitate sustainable investment by means of providing a unified classification system for environmentally sustainable economic activities. In this light, the EU taxonomy would support both public and private investors as well as policy makers with appropriate definitions for which economic activities can be considered environmentally sustainable. It should contribute to protecting private investors from greenwashing and to help companies to become more climate-friendly while shifting investments to where they are most needed.

Source: https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en

Challenges

According to a recent European Court of Auditors (ECA) report, the Commission fell short of its self-imposed target to spend 20% of the EU budget for 2014-2020 on climate action. The ECA reported that the Commission's estimated spending was not always effectively relevant to climate action. The report highlights that the Commission overstated international climate finance by more than EUR 72 billion. This in turn would mean that only 13% of the EU budget (2014-2020) has actually been dedicated to climate action. To improve future reporting on climate spending, the ECA recommended that the Commission obtain scientific evidence to support the contribution from agricultural policy, the largest component of the EU's climate reporting. Also recommended is enhancing climate reporting by identifying EU spending with a potentially negative climate impact, issuing guidelines to ensure consistency, and taking stock of unused amounts.

With climate targets far from achieved, there is enormous room for improvement overall regarding international climate finance. Nonetheless, according to the Environmental Performance Index (EPI) 2022, which provides a databased overview of the state of sustainability in the world, EU MS are generally among the highest-performing countries. This results from long-standing and ongoing investments in policies that protect environmental health, preserve biodiversity and habitats, conserve natural resources, and decouple greenhouse gas emissions from economic growth. The framework and funding for international climate finance provided by the EU has contributed to the high ranking of its MS.

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This document is available on the internet at: www.europarl.europa.eu/supporting-analyses
Print ISBN 978-92-848-0150-3 | doi:10.2861/430065 | QA-08-23-028-EN-C
PDF ISBN 978-92-848-0151-0 | doi:10.2861/051214 | QA-08-23-028-EN-N