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Game-changer: Financing the European Green Deal



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Mrs von der Leyen has proposed an ambitious European Green Deal. This briefing, prepared by civil society organisations, welcomes the proposal and calls on the new Commission President to equip the proposal with a financing framework equal to the task.

We believe that a real, game-changing Green Deal is feasible in the short-term – but only if the European Commission can succeed in overhauling the conditions for both private and public financing.

Introduction

The EU's actions on climate have in the past faced opposition from some Member States. However, the overarching nature of a 'Green New Deal' is an opportunity to unite the Member States interests around an ambitious shared objective, with many possibilities for negotiation and compensation to address national differences.

A meaningful 'European Green Deal' should aim for a top-to-bottom, long-term mobilization of public and private efforts in favour of a just transition towards a climate neutral and sustainable economy, leaving no one behind. It is vital that Mrs von der Leyen's plans are executed alongside a bold financial plan that will not be seen as "old wine in new bottles".

A successful financing framework for the Green Deal will add to the Commission's ongoing initiatives, such as the Sustainable Action Plan and Capital Markets Union, while reflecting today's context and priorities. Top of this list is the much greater urgency facing policymakers, with only a few years left to avoid catastrophic climate and environmental change. Green finance must be directed at decarbonising the economy and protecting biodiversity, while protecting the EU's citizens from the consequences of the dramatic shifts needed to meet these goals.

Financial markets remain fragile and interest rates are historically low. The financial sector must become resilient to new types of risk as well as those unresolved since the global financial crisis. Low interest rates mean governments can borrow at negative interest rates but are also holding back bank profitability. Faced with the possibility of another crisis, central banks have little room to reduce interest rates and will need to explore innovative monetary policies.

Finally, the announcement of a new Commission position, Executive Vice-President for the European Green Deal (nominated as Frans Timmermans) ensures high level support for the Green Deal. It is vital that this position can coordinate closely with the work of the economy and financial services Commissioner (nominated as Valdis Dombrovskis), in order to deliver the financial framework needed.

Against this context, we offer a list of recommendations that we hope policymakers will draw from when building a European financing framework to meet the demands of the Green Deal.

Summary of recommendations

Shifting private finance from brown to green:

- Amend the non-financial reporting directive to ensure mandatory and harmonized ESG corporate reporting;
- Bring a legislative proposal on human rights and environmental due diligence;
- Make the 'Green taxonomy' mandatory for green products and create a 'Brown taxonomy';
- Deliver a consistent 'EU Ecolabel' for retail investors;
- Give institutional investors a duty to reflect their customers' sustainability preferences;
- Penalize brown bank lending in prudential regulations;
- Implement existing proposals to reduce short-termism in financial markets;
- Revise the CMU strategy to reduce systemic risk and integrate sustainability measures;
- Review the Credit Rating Agency regulation to ensure integration of ESG risks;
- Use stress tests and macroprudential tools to reduce climate-related financial risks;
- 'Green' the ECB's collateral framework and corporate bond asset purchases.

Mobilising public finance to help fund the transition:

- Link the European Semester to the EU's environment and social targets;
- Give the new Commissioner for the Green Deal the ability to influence financial policy;
- Reform fiscal rules to facilitate public investment in decarbonizing the economy;
- Eliminate fossil-fuel subsidies via a reporting regime and phase-out plan;
- Double the portion of the EU's budget spent on climate and environment from 25% to 50%;
- Ensure that all EU spending is consistent with Paris Agreement goals;
- Use the EU's Cohesion Fund to increase funding for a 'Just transition';
- Increase the size of the 'InvestEU' fund and give it a greater focus on climate;
- Upgrade the EIB with more capital, stronger governance, a fossil-free mandate, and green bond programme;
- Mobilise funding from the EBRD and the Council of Europe Development Bank;
- Develop the EU's network of National Promotional Banks;
- Review the impact of State Aid rules on National Promotional Banks;
- Publish a Communication on "The role of NPBs in the European Green Deal";
- Adopt a 'market-shaping' approach in competition rules;
- Promote fossil-free approaches by export credit agencies and other public financial institutions;
- Revise the EU Energy Tax Directive to meet Paris Agreement goals.

1. A CHANGE IN FINANCIAL REGULATION TO REDIRECT PRIVATE FINANCIAL FLOWS FROM BROWN TO GREEN ACTIVITIES

Ursula von der Leyen

*"We need to tap into private investment by putting green and sustainable financing at the heart of our investment chain and financial system. To achieve this, I intend to put forward a **strategy for green financing**."*

*"We will **complete the Capital Markets Union** to ensure SMEs have access to the financing they need to grow, innovate and scale up."*

Political guidelines for the next European Commission 2019-2024, p.6 & 8¹

Mrs von der Leyen's reference to a strategy for green financing must surely be understood as the follow up of the 2018 'Commission action plan on financing sustainable growth'. While this Action Plan is a very good basis and must be pursued towards full implementation, it never covered the full scope of what is required: the proposals are largely for reforms to increase investment in green assets. But **growing the green finance niche while not properly addressing the brown economy will not lead Europe towards a sustainable economy**. The debate is moving fast — with a recent report² casting doubt on the decoupling hypothesis that it could be possible to have both economic growth and a significant reduction of environmental harm — but time is running out: we need to shift rapidly away from brown finance as we increase allocation to green finance.

The welcome nomination of **Frans Timmermans** as a new executive vice-president for the European Green Deal is undermined by the fact that his **mission letter excludes financial services** – which are crucial to fight climate change. A real, game changing Green Deal is immediately feasible provided the European Commission can overhaul and develop further the private and public financing conditions in the EU in a way that is coherent with the objectives set for the climate. This will require a **strong cooperation between the Green Deal and Economy Commissioners**: the executive vice-president for the European Green Deal (nominated as Frans Timmermans) and the executive vice-president for an Economy that Works for People (nominated as Valdis Dombrovskis), who would oversee much of what would be necessary for a Green Deal (European Semester, EIB, Green financing strategy, etc.).

¹ Ursula von der Leyen, "A Union that strives for more: My agenda for Europe", https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf

² PARRIQUE, T., BARTH, J., BRIENS, F., C. KERSCHNER, KRAUS-POLK, A., KUOKKANEN, A., SPANGENBERG, J.H., Decoupling debunked: Evidence and arguments against green growth as a sole strategy for sustainability, European Environmental Bureau, 2019, 80p., Url.: <https://eeb.org/library/decoupling-debunked/>

1.1 REVIEWING THE NON-FINANCIAL REPORTING DIRECTIVE (NFRD)

Action 9 of the Sustainable Finance Action Plan calls for strengthening sustainability disclosure and accounting rule-making. It provides an excellent opportunity to refocus corporate reporting on sustainability. A good first step would be to **ensure mandatory, harmonized and integrated reporting by large companies,³ and smaller companies in high-risk sectors, on their risks, dependencies and impacts on the environment** (i.e. ‘double materiality’). The information reported would help a wide range of stakeholders — corporates, policy makers, consumers, financial institutions, supervisory authorities and central banks - to properly integrate sustainability in their own decision-making processes. This will require a few strategically chosen, and sector-specific, key performance indicators (KPIs) to enable comparison between peers. The transparency and comparability achieved should drive upwards competition between peers on sustainability performance.

1.2 CREATING AN EU-WIDE FRAMEWORK FOR CORPORATE HUMAN RIGHTS AND ENVIRONMENTAL DUE DILIGENCE

In Action 10 of the Sustainable Finance Action Plan (Fostering sustainable corporate governance and attenuating short-termism in capital markets), the Commission committed to explore corporate due diligence, directors’ duties, and corporate sustainability strategies and targets. On this basis, the Commission needs to table a **legislative proposal on human rights and environmental due diligence for large European corporates** (including throughout their value chain) as well as **SMEs in high-risk sectors**. It should build on the UN Guiding Principles on Business and Human Rights, the OECD’s Guidelines on Responsible Business Conduct and existing legislative precedents such as France’s duty of vigilance law. It should include civil liability and remediation in case of significant harm.

1.3 COMPLEMENTING THE ‘GREEN TAXONOMY’ WITH A ‘BROWN TAXONOMY’

Defining the greenest economic activities in the sectors most relevant for climate and environment (e.g. energy, transport, construction, manufacturing, agriculture) is a useful way to indicate the direction of travel and can help avoid greenwashing by creating a common and harmonized language. However, it is only the first step: once achieved, such a green taxonomy will **need to become mandatory for any green financial product** distributed in the EU, otherwise the language will not be common.⁴ Even more importantly, what is needed is a commonly agreed language on the degree of sustainability of various economic activities either through a ‘fully-fledged taxonomy’ or, at least, through a **‘brown taxonomy’** (as publicly requested by the NGFS⁵ and

3 While EU rules on non-financial reporting only apply to large public-interest companies with more than 500 employees (~6000 companies in EU), accounting directives refer to 250 employees (Art 3.4.c.). For the sake of consistency, and to ensure a sufficient coverage, non-financial reporting should apply to companies with more than 250 employees.

4 Attempts from several Member States to delete article 4.3 and 4.4 and make voluntary the use of the technical screening criteria, should be strongly resisted.

5 **The NGFS encourages policymakers to develop a ‘brown taxonomy’** that provides transparency on which economic activities are more exposed to climate and environment-related risks (the Network for Greening the Financial System is composed of more than forty Central banks and supervisory authorities e.g. Bundesbank, BaFin, Banque de France, Bank of England). By proposing that the ‘brown taxonomy’ should target both physical and transition risks, the NGFS go one step further by proposing not only to target activities which are detrimental to the environment and could be stranded (i.e. transition risks), but also those that are at risk of facing loss due to climate change (i.e. physical risks).

more recently by the ECB⁶). This would be more relevant for investors and supervisory authorities concerned with financial risk because **brown sectors are where most climate and environment-related financial risks lie** (e.g. from regulatory changes, taxation, litigation, asset stranding, physical climate impacts). This is a necessary step to ensure that capital requirements and other prudential rules take account of sustainability-related financial risks (see below).

1.4 EMPOWERING RETAIL INVESTORS TO DECIDE WHERE THEY INVEST THEIR MONEY

A consistent ‘EU Ecolabel’ for the greenest financial product should be completed, for example using a ‘thermometer-shaped label’ to ensure that **investment products are labelled according to their degree of sustainability** (and notably their degree of alignment with the climate Paris agreement). In addition, retail investors should be properly asked about their sustainability preferences by financial advisers and be offered adequate sustainable financial products that match their preferences and that can demonstrate positive impact while avoiding misleading claims. This will mean reopening several regulations (e.g. PRIIPS, UCITS) to ensure a consistent European approach with harmonized indicators and to develop a robust, granular framework to prevent greenwashing and measure the sustainability impacts of funds.

1.5 CLARIFYING INVESTOR DUTIES AND DUE DILIGENCE

While the EU has made the first steps on disclosure of due diligence (i.e. EU Disclosure Sustainability Regulation), more will be needed. As recommended by the HLEG, the Commission should revise existing legislation (e.g. IORP II, AIFMD, MiFIR, Solvency II, Shareholder Rights Directive) to ensure that: (1) end-investors are consulted about their **sustainability preferences** (i.e. investor duties), which should not be limited to those that are financially material; (2) **mandatory due diligence covers all ESG risks and impacts** with robust enforcement mechanisms and sanctions; (3) asset managers exercise their **shareholder rights in alignment with the sustainability preferences** of their clients’ end-investors.

1.6 PENALIZING BROWN FINANCING AND IMPROVING BANK STABILITY

Taking into account the sustainability risks that banks are facing by holding brown assets, they should be required to finance themselves with more loss-absorbing equity in relation to such assets. By **tabling a ‘Brown Penalizing Factor’ in prudential regulation** (i.e. CRDV/CRR II) on the basis of the forthcoming EBA report on the issue, Mrs von der Leyen could both improve bank stability while reducing lending to brown assets.⁷ While it is no longer a popular topic, **financial stability** is a precondition for sustainable growth, not a barrier to it.

6 “The European Commission has made a proposal on defining sustainable assets, which is now being discussed. This proposal just classifies “green” assets, though. **To get the full picture, we would also need to classify “brown” assets.**” Speech by Pentti Hakkarainen, Member of the Supervisory Board of the ECB, at the Hannes Snellman Financial Law Seminar, Helsinki, 9 September 2019.

7 **Up to 8% according to different scientific sources.** E.g. THOMÄ, J., GIBHARDT, K., “Quantifying the potential impact of a green supporting factor or brown penalty on European banks and lending”, Journal of Financial Regulation and Compliance, Vol. 27 No. 3, 2019, p. 380-394 ; NOSS, J., TOFFANO, P., “Estimating the impact of changes in bank capital requirements during a credit Boom”, working paper No. 494, Bank of England, London, 2014.

1.7 REDUCING SHORT-TERMISM NOW

Short-termism was widely discussed as a driver of the 2008 global financial crisis but never properly tackled. The issue is now back in the discussion as the awareness of the climate crisis grows. While the Commission requested the European Supervisory Authorities (ESAs)⁸ to investigate sources of undue short-term pressures as part of its Action Plan, this is hardly a new topic needing endless research: **the factors driving financial short-termism and potential countermeasures⁹ are already acknowledged and documented.** Mrs von der Leyen should make it a key target of the European Green Deal to act on this body of knowledge and tackle the causes of short-termism.

1.8 REVIEWING THE STRATEGY OF THE CAPITAL MARKET UNION (CMU)

The current lack of economic dynamism and job creation in the EU is linked to a range of factors, of which SMEs' access to credit is not especially significant.¹⁰ While the choice of the previous Commission to promote non-bank lending through the CMU agenda rather than traditional banking is highly debatable,¹¹ we want to stress that this agenda should not detract from (1) **the missing elements in the post-crisis financial reform agenda** such as bank structure reform and shadow banking regulation needed to reduce systemic financial risk, and (2) **the importance of hardwiring sustainability in capital market practice** (e.g. through MiFID II, PRIIPS).

1.9 REVIEWING THE CREDIT RATING AGENCY REGULATION (CRA)

Given that the promotion of non-bank lending through the CMU agenda increases the market's reliance on external credit assessments, the Commission should revise the CRA regulation to (1) **ensure that CRAs adequately disclose their methodologies and skills for discharging their duties;** (2) **properly integrate ESG risks into their credit risk analysis and ratings,** (3) as recommended by the HLEG, integrate mid-term issues in separate 'rating outlooks' to provide longer-term analysis.

⁸ The ESAs are composed of the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

⁹ E.g. better disclosure of portfolio churn (i.e. excessive portfolio turnover), taxes on short ownership, addition voting rights for long ownership, fiduciary duties that recognise long-term objectives, longer-term remuneration structures for company directors and asset managers, better disclosure of asset managers' costs, long-term oriented reporting structures for company directors (moving away from quarterly reporting), ending public subsidies to speculative practices via too-big-to-fail banks, limiting herd behaviour from indexes, limiting high frequency trading.

¹⁰ According to the Survey on the Access to Finance of Enterprises (SAFE), which was conducted between 11 March and 16 April 2019 by the ECB, availability of skilled labour remained the dominant concern for euro area SMEs, together with the difficulty of finding customers, while access to finance was considered the least important obstacle. Source: https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/ecb.safe201905-082335a4d1.en.html#toc1

¹¹ For example: <https://www.finance-watch.org/publication/capital-markets-union-in-5-questions/>.

BOX N°1 - THE ROLE OF CENTRAL BANKS AS MONETARY AND SUPERVISORY AUTHORITIES

A consistent Green Deal would require that all EU institutions deliver their best efforts in fighting climate change and addressing the risks to society. Furthermore, climate change is also a financially material issue¹² that will impact financial stability: in its '2019 risk map for the banking sector' the ECB features, for the first time, climate risk as one of the key risks for the European banking sector. Considering both their financial and price stability mandates and the impact that central banks can have on banks and capital markets, central banks should take the following measures:

- **Conducting environmental financial stress tests** - The growing awareness of the materiality of climate and environment-related financial risks must lead to an analysis of the risks faced by financial institutions through forward-looking scenario analyses. Central banks and supervisory authorities must then make full use of their macroprudential toolbox (e.g. differentiated reserve requirements, large exposures limits, sectoral capital buffers targeting credit to particularly climate-exposed sectors¹³) to ensure early market movement away from brown activity, allowing for a soft landing and a reduction of the financial and potentially systemic risks related to climate and environmental breakdown, while avoiding a disorderly and costly transition.
- **Greening the ECB's collateral framework** - Banks receive liquidity from central banks in exchange for assets pledged as collateral. In the Eurozone, the criteria for which assets are eligible as collateral, as well as its 'price' (aka 'haircut'), are based on the financial risks of the asset. But assets related to brown activities are becoming ever more risky as 'transition risks' are gradually materialising (as already happening in the power sector) and may lead to a growth in stranded assets and potentially massive losses of portfolios value, with 'no place to hide' for large diversified financial institutions. These increasing risks have to be mirrored in the central banks' collateral frameworks, either by increasingly excluding the most carbon-intensive assets, or by assigning them a higher haircut.¹⁴ This would disincentivize banks from holding such assets.
- **Leading by example** - Following a misleading conception of 'market neutrality' in their asset purchase programme, central banks are buying a significant amount of corporate bonds from carbon-intensive companies, locking society to an unsustainable path by indirectly 'subsidizing' these companies. Central banks must lead by example and be consistent with their financial stability mandate by divesting from brown assets (unless carbon-intensive corporates commit to a timebound Paris alignment) as they are more risky, both financially (transition risks) and for the achievement of the EU's public policy objectives.
- **Ensuring the use of proper credit ratings** - The ECB should reduce its excessive reliance on external credit ratings that do not properly take into account climate- and environment-related financial risks when conducting credit assessments. More precisely, the ECB should review its Eurosystem credit assessment framework (ECAF) with a view to ensuring that none of its external credit assessment institutions are overlooking climate and environment factors.

12 Without mitigation efforts, physical risks related to climate change could lead to a loss of \$2.5 to \$24.2 trillion of the value of global financial assets (DIETZ, S., BOWEN, A., DIXON, C., GRADWELL, P. (2016), "'Climate value at risk' of global financial assets", Nature Climate Change, Vol. 6, No 7, pp. 676-679). Furthermore, Mercure et al. (2018) estimate that discounted global wealth losses from stranded fossil fuel assets may amount to \$1 to \$4 trillion. (in: MONNIN, P., Central banks should reflect climate risks in monetary policy operations, CEP, SUERF Policy Note Issue No 41, September 2018).

13 See: KROGSTROP, S., OMAN, W., Macroeconomic and Financial Policies for Climate Change Mitigation: A Review of the Literature, IMF, Working Paper No. 19/185, 2019, 58p., p.28; D'ORAZIO, P., POPOYAN, L., Fostering green investments and tackling climate-related financial risk: which role for macroprudential policies?, LEM, Working paper series, 2018/35; SCHOENMAKER, D., VAN TILBRUG, R., What role for financial supervisors in addressing environmental risks?, 2016, Comparative Economic Studies, 58(3), p.317-334.

14 As proposed in: SCHOENMAKER, D., Greening monetary policy, Bruegel, Working paper, Issue 02, 19 February 2019.

2. A MASSIVE PUBLIC INVESTMENT PLAN FOR NATURE, TO FINANCE PUBLIC GOODS AND OUR COMMONS

In pursuit of a climate-neutral and sustainable economy, **some transition activities are not profitable enough to attract private financing**. For example, providing insulation for public and private buildings, renaturalizing soils, and many other activities may never be profitable in a narrow financial sense. Parts of some projects may be too risky, too complicated, or too small to be considered ‘bankable’ and attract large institutional investors. And much of the sustainable infrastructure needed for the transition are public goods and will require public funding, at national or EU level.

For some years, the dominant narrative in this area has been that public finance’s main task should be mainly to de-risk private investment. We believe it can do much more than that: **a Green Deal should unlock public finance directly to fund the transition**, focussing on areas where public goods are involved and where households, enterprises and local authorities need help to overcome initial investment costs of the ecological transformation.

REORIENTING NATIONAL ECONOMIC AND BUDGETARY POLICIES

Ursula von der Leyen

*“I will make full use of the **flexibility** allowed within the **Stability and Growth Pact**”*

*“I will **refocus the European Semester** into an instrument that integrates the United Nations Sustainable Development Goals”*

Political guidelines for the next European Commission 2019-2024, p.9

The European Semester guides and coordinates national economic policies. The need to ensure coherence between the design and the implementation of the National Energy and Climate Plans (2021-30) and the recommendations under the European Semester (ES) has been recognized by the Commission (COM(2019) 285, par. 2.3.3). However, the modalities of the European Semester were adopted nearly one decade ago in the wake of the financial crisis and now need to be updated to become the basis for implementing an urgently-needed strategy for a just ecological transition.

The European Semester should therefore go beyond a mere reference to “integrating the UN SDGs” by explicitly referring to the environment and social targets set by the European Union today and taking account of the changed global macroeconomic context.

It is also necessary to **correct the overreliance on financial indicators** as opposed to environmental or other types of indicator, and **the domination of fiscal and economic procedures** (the only two formal procedures within the European Semester that may result in sanctions relate to excessive budget deficits and macroeconomic imbalances). As part of this correction, the guidelines for implementing these two procedures as edited by the Commission should be subject to a broad and transparent consultation involving academia and civil society.

2.1 REFORMING THE EUROPEAN SEMESTER

Within its first 100 days, we hope the new Commission will table a proposal to update the legislation introduced to strengthen the Growth and Stability Pact in the context of the European Semester (the so called Six-Pack and Two-Pack) **to fully integrate the goals of a sustainable and fair ecological transition**. This proposal should be subject to a broad consultation at the European and national levels. We believe that the European Semester should be reformed in the following ways:

- **Country reports and country-specific recommendations should capture key environmental and social issues and related policy parameters**, e.g. harmful subsidies and environmental taxation, as well as performance against key environmental and climate objectives and indicators.
- **Widening the scope of the procedure on macroeconomic imbalances** - The scope of the procedure on macroeconomic imbalances should be widened to include equal consideration of social, environmental, economic and financial features that could potentially harm the present and future wellbeing of people. Key indicators should be included in the main scoreboard of indicators in the Macroeconomic Imbalance Procedure, including on climate, energy, resource efficiency (i.e. total material use, soil, water, land use), pollution and biodiversity.
- **Reforming the fiscal rules** - The Excessive Deficit Budget procedure needs a **deep and climate-focused reform to its fiscal rules** to allow for a more forward-looking balance between the political and financial risks of not complying with fiscal rules introduced to tackle the Eurozone crisis nearly a decade ago and the existential risks to future generations from not meeting climate and environmental objectives. In particular, **the flexibility clause should be amended to exclude public investment in decarbonizing the economy from the calculation of the national deficit**, or at least have a favourable statute. Moreover, the new rules will have to take explicitly into account the changed macroeconomic global context characterized by low interest rates, low investment rates and persistent weak global demand, persistent income and employment divergences among European countries. Inconsistencies in 'output gap' calculations should also be addressed.¹⁵
- **Enhancing green budgeting** - On average, environmental taxes represented only 6% of all taxes in EU Member States in 2017;¹⁶ even more worrying, this figure was lower than in 2016. As proposed by DG ECFIN for the next Commission, the Commission should issue forceful recommendations to Member States on how to mainstream environmental considerations in national fiscal policy making, including by issuing standards for eco-budgets.
- **Making decision makers accountable** - To ensure greater transparency and accountability at European and national level, **the Economic Dialogue¹⁷ should ensure a greater involvement of the competent commission of the European Parliament (EP), and of representatives of national parliaments**. The competent EP's commission should be empowered to invite at any stage of the procedure, including before decisions are taken by the Commission or the Council, the President of the Council, the Commission and, where appropriate, the President of the European Council or the President of the Eurogroup to appear before the committee to discuss issues pertaining to the European Semester. **Representative of national parliaments** should have the right to participate as active observers whenever the competent commission of the European Parliament meets to discuss issues pertaining to the European Semester.

¹⁵For more information, see this Bruegel brief on the ongoing 'Campaign against nonsense output gaps': <https://bruegel.org/2019/06/the-campaign-against-nonsense-output-gaps/>.

¹⁶European Commission 2017, https://ec.europa.eu/eurostat/statistics-explained/index.php/Environmental_tax_statistics.

¹⁷ as provided for in the Six- and Two- pack.

2.2 STOPPING ENVIRONMENTALLY HARMFUL SUBSIDIES, NOTABLY FOR FOSSIL FUELS

The Commission should **ensure that EU public funding does not support fossil fuels anymore and urge Member States to do the same with national public funding.**

As early as 2009, the European Council asked the Commission to review, as a matter of urgency, sector by sector, subsidies that have considerable negative effects on the environment with a view to gradually eliminating them. Since then, the Commission and the Member States have made little progress towards this call. According to a 2019 Commission report,¹⁸ Member States' subsidies for fossil fuels remained at €54-55 bn despite the EU's international commitments to phase them out. In their draft National Energy and Climate Plans (NECP), Member States do not list all their fossil fuel subsidies and neither do they commit to fossil fuel subsidy phase-out plans, as they are required to do.¹⁹ The new Commission will thus have to ensure that the reporting of fossil fuel subsidies and phase-out plans are fully implemented through the Energy Union Governance Framework.

2.3 INTRODUCING A SUSTAINABILITY TEST

Furthermore, the Commission should introduce a sustainability test for all the investments within the EU budget, ensuring that the entire Multiannual Financial Framework (MFF) is spent in line with the objectives of the Paris Agreement and takes into account the EU's climate neutrality objective.

ENSURE A SUFFICIENT CONTRIBUTION AT THE EUROPEAN LEVEL

Ursula von der Leyen

***"The Sustainable Europe Investment Plan** will support €1 trillion of investment over the next decade in every corner of the EU"*

*"We will support the people and regions most affected through **a new Just Transition Fund**"*

Political guidelines for the next European Commission 2019-2024, p.6&5

Mrs von der Leyen proposes a Sustainable Europe Investment Plan to support €1 trillion of investment over the next decade. It is not yet known how the €1 trillion will be funded and whether it will bring additional money or simply wrap up existing allocations from InvestEU and the EU budget. However, the amount of €1 trillion is far too small to meet the European Commission's estimate of €2.6 trillion needed over the next decade (COM(2019)285 final, Par. 2.3.3). This leaves on average a gap of 1.5 to 2% of GDP to be filled by national sources.

¹⁸COM(2019) 1 final, Energy prices and costs in Europe - PART III Energy subsidies and government revenues from energy products, Brussels, 9.1.2019, p.211.

¹⁹VAN DER BURG, L., TRILLING, M., GENCSÜ, I., Fossil fuel subsidies in draft EU National Energy and Climate Plans - Shortcomings and final call for action, Working paper 562, FoE Netherlands, CAN Europe, ODI, Septembre 2019, Url.: <https://www.odi.org/sites/odi.org.uk/files/resource-documents/12895.pdf>

2.4 MAKING THE EU BUDGET MATCH THE SCALE OF THE CHALLENGE

While some investments have to take place at national level, others are better dealt with at EU level. But the EU allocation for climate mainstreaming is only half what is needed to be. On a proposed total EU budget of €1,135 billion for 2021-27 (about 1% of the EU's GDP), the Commission has set a target of 25% for contributing to climate objectives (€320 bn). This 5% increase from the previous EU budget does not match the size of the challenge. **The climate and environment spending target of the EU budget should be increased to 50% of the total at least.** In addition, the Commission should improve its monitoring tools to **ensure that only genuine climate mitigation and biodiversity protection initiatives count towards this target.** Currently, significant amounts of direct payments to farmers are accounted as climate action without the need to prove a climate benefit. Further, it should establish **a new climate proofing mechanism** to ensure the entire EU budget is climate-friendly, and to ensure that underlying EU funds, spending strategies, plans and programmes are embedded in regional and sectoral decarbonisation pathways and apply the Energy and Resource Efficiency First Principle. More fundamentally, an EU Green Deal should involve a **real prioritisation and expansion of the EU budget towards sustainable investments** of EU relevance, such as an EU-wide electricity networks (EU smart grids), an EU-wide plan to better integrate European railway networks and lower its costs, the insulation of all public buildings by 2030, etc.

2.5 MAINSTREAMING THE JUST TRANSITION ISSUE

Mrs von der Leyen presented her proposal for a Just Transition Fund with the words "This is the European way: we are ambitious and we leave nobody behind". This is a very welcome start and it will require **a dedicated, mainstream source of funding.** So far, the only funds foreseen are the current proposal of the European Parliament for only EUR 4.8bn, based on existing funds and programmes without mobilising new financial resources. What the most affected EU regions need is not a small 'Just transition fund' which is supposed to complement the action of other and more consistent existing funds (e.g. Cohesion Policy funds, European Social Fund +, Innovation and Modernisation Funds), but **a 'Just transition' focus mainstreamed and integrated into all existing funds.** With more than 70 times the resources of the proposed Just Transition Fund, the Cohesion Policy could be a better starting point and has more potential to tackle energy poverty and support quality and sustainable jobs. The Commission must ensure that Member States and Regions prioritise the Just Transition in all its dimensions in the upcoming development of EU spending plans and programmes, pursuing an integrated approach and putting the Just Transition at the centre of Operational Programmes.

2.6 MAKING EU FINANCIAL INSTRUMENTS MORE AMBITIOUS AND RELEVANT

The successor of President Juncker's 'European Fund for Strategic Investments' (EFSI) is **the 'InvestEU Fund'**, a fusion of 15 already existing EU financial instruments (e.g. EFSI, CEF, COSME, NCF) in a smaller fund of €15.2 bn, linked to a €38 bn EU guarantee. The new scheme is expected to leverage €650 bn of finance in total by derisking private investment through public guarantee. This is twice the amount of financing targeted by EFSI but still **does not match the scale of the challenge:** even if it succeeded in leveraging the planned amount of private investments, these would still represent only

10% of the European investment gap in sustainable infrastructure.²⁰ In addition, the climate orientation of the InvestEU Fund is still to be clarified: to date, unbelievably, fossil fuel investments and high-carbon transport infrastructure are still eligible under the InvestEU regulation, which has yet to be adopted. Therefore, **the ‘InvestEU Fund’ should be expanded and have climate standards included and additionality strengthened to match the funding gap**. Furthermore, to ensure that InvestEU funding can reach “every corner in the EU” and not be captured by a few countries, there should be **appropriate technical assistance** for Member States with less capacity to respond to the funding opportunities.

2.7 USE DEVELOPMENT FUNDS TO SUPPORT A JUST TRANSITION OUTSIDE THE EU

European **development aid and finance should aim to export the Green Deal to third countries outside of Europe**, by ensuring it finances future-proof projects that contribute to sustainable development and ecological transition there. This should be a prominent element in the ongoing discussions and future recommendations of the High-Level Group of Wise Persons on the European financial architecture for development.

Ursula von der Leyen

*As part of this, I will also propose to **turn parts of the European Investment Bank into Europe’s climate bank**. The bank is already the largest multilateral provider of climate finance worldwide, with 25% of its total financing dedicated to climate investment. I want to at least **double this figure by 2025**.”*

Political guidelines for the next European Commission 2019-2024, p.6

The proposal to **make the EIB a climate bank and to double its financing dedicated to climate** (which amounted to €16.2bn in 2018) must be acknowledged as two excellent proposals. However, five complementary issues should be taken into account on the EIB and public banking more generally:

2.8 UPGRADING THE EIB TO FIT THE CHALLENGE

The EIB should (1) be **better capitalised** in order to expand the scope of its climate and environmental protection funding, (2) become **fossil-free**, as rightly proposed in its recent draft ‘Energy lending policy’ that the Commission needs to support, (3) undergo deep **governance reforms** to become a more democratic and accountable institution,²¹ (4) become **less risk-averse** to support more risky projects if they have a significant sustainability added value, and (5) **launch a major green bond issuance programme** (with such bonds bought especially by the European Central Bank, see point below).

20 RUBIO, E., VIREL, F., InvestEU Fund: A rebranded Juncker Fund?, Jacques Delors Institute, Policy Brief, 26 Sept 2018, p.5.

21 See the Financial Times article “European Investment Bank: the EU’s hidden giant”, July 2019, <https://www.ft.com/content/940b71f2-a3c2-11e9-a282-2df48f366f7d>.

2.9 MAKING BEST USE OF OTHER EUROPEAN MULTILATERAL BANKS

EU Member States are majority shareholders of the EBRD and the Council of Europe Development Bank: these banks and their specific experience and comparative sectoral or geographical advantage should be duly considered when building up the governance of European financing for a just transition. Their focus on investments to reduce inequalities between citizens and between territories across Europe is a prerequisite for public investments to deliver a fair ecological transition.

2.10 EXPANDING THE ROLE OF PUBLIC BANKING

In line with the principle of subsidiarity, a Green Deal should not only be financed via a top-down approach using the EIB and centralised budget lines, but should rather rely on **a web of local, regional and national financial institutions** with a better understanding of local contexts in order to support small projects that institutions like the EIB are not able to support directly. Problematically, more public banking with the same rules²² will not close the investment gap in non-bankable projects, notably projects with public good characteristics, long payback periods, or low risk/reward. An EU Green Deal should also enable **European National Promotional Banks (NPBs) to provide more preferential long-term loans to fund a just transition** to a sustainable and carbon-neutral economy, with below market rates when required. Several steps could help this:

- **Revisiting State Aid rules** - Since National Promotional Banks (NPBs) receive state support,²³ the Commission considers their interventions to qualify as State Aid if all the other criteria of Art. 107(1) TFEU are met.²⁴ Meanwhile, there is **room for manoeuvre for states to make the best use of their NPBs** and redirect financial flows through long term loans supporting some sectors.²⁵ Despite a general prohibition on State Aid, exemptions can be applied based on the amount of aid (i.e. 'de minimis regulation'²⁶), the categories (i.e. the General Block Exemption Regulation or GBER allows state aid for underdeveloped regions, SMEs and, crucially, for environmental protection), or the existence of specific guidelines (i.e. the Rescue and Restructuring Guidelines issued in response to the 2008 crisis)²⁷. While these evolutions were added to meet specific contexts, such as a financial crisis or Member States' preferences (via the GBER), **growing concerns about climate change and environmental degradation should lead to a re-examination of the State Aid regime**. If Mrs. von der Leyen's green finance strategy is to be comprehensive and go beyond the narrow range of bankable projects that can appeal to private financiers, it should at least include (1) an **in-depth study of barriers to action by NPBs**, which should lead to (2) a **clarification of the scope of NPBs' actions and suitable recommen-**

²²On the one hand, the EIB, as well as some National Promotional Banks (NPBs), have been frequently criticised for conservative investment practices. This can be explained by their desire to keep excellent credit rating as EU competition rules incentivize them to finance their operations on international markets. On the other hand, they are requested to practice market-based pricing policies in order to avoid unfair competition with private financing institutions (e.g. in line with the Guarantee Notice (2008/C 155/02), the Reference Rate Communication (OJ C 14, 19.1.2008)).

²³NPBs resources are qualified as 'state resource' in the meaning of Art.107(1) TFEU. They also generally benefit from a State guarantee.

²⁴Confer advantage on a selective basis, distort competition, and affect trade between Member States (Art 107(1)).

²⁵See for example the case of the German's KfW in: NAQVI, N., HENOW, A., CHANG, H-J., Kicking away the financial ladder? German development banking under economic globalisation, Review of International Political Economy, July 2018, 37p.

²⁶According to the 'de minimis regulation', aid granted to any one organisation below €200,000 over three fiscal years is considered too small to be market distorting.

²⁷CALVERT JUMP, R., NAQVI, N., Financial and legal barriers to the creation and operation of a British national investment bank, UCL Institute for Innovation and Public Purpose, Policy report WP 2019-07.

dations (e.g. a communication on “The role of NPBs in the European Green Deal”), and, if deemed necessary, (3) a **review of State Aid rules and the regulatory environment for NPBs**.

- **Challenging the ‘market-fixing approach’** - Furthermore, an in-depth EU discussion on the appropriateness to **reform competition rules to move from a ‘market-fixing approach’ to a ‘market-shaping approach’²⁸** could be necessary to enable the EU to tackle the ‘Grand challenges’ of the century, echoing the mission-led thinking that the Commission is already taking in research and innovation under its Horizon Europe programme.²⁹

2.11 LINKING PUBLIC INVESTMENTS TO MONETARY POLICIES

Pursuing the same line of thought, **bonds issued by NPBs and the EIB should be preferentially bought by the European Central Bank (ECB)** when conducting its monetary policies. While the ECB is already buying some NPB and EIB bonds as part of its quantitative easing (see the ECB’s Public Sector Purchase Programme), expanding the amount and publicizing it could act as a form of guarantee, which could both (1) lower NPBs’ and the EIB’s cost of financing and (2) enable them to take more risks (e.g. fund uncertain R&D, new technology, experimental projects) and fund less bankable projects.

2.12 ENSURING THAT PUBLIC FINANCIAL INSTITUTIONS LEAD BY EXAMPLE

Public financial institutions such as the Development Finance Institutions (DFIs) and Export Credit Agencies (ECAs) should adopt clear red lines for their own operations, for instance on ending fossil fuel support and do-no-harm practices.

2.13 IMPROVE THE CONSISTENCY OF EU-LEVEL ENVIRONMENTAL TAXES

In addition to phasing out environmentally-harmful subsidies, environmental fiscal reform is necessary to tax the ‘bads’ (pollution, overconsumption of energy and resources, waste) not the ‘goods’ (labour). **The EU Energy Tax Directive should be urgently reviewed to ensure its consistency with the Paris Agreement.** As suggested by DG ECFIN for the next Commission, minimum tax levels for example for carbon kerosene shipping should be ensured to provide the right incentives.

²⁸For more discussion: MAZZUCATO, M., PENNA, C., Beyond Market Failure: The Market Creating and Shaping Roles of State Investment Banks, Journal of Economic Policy Reform, Volume 19, 2016 - Issue 4, <http://dx.doi.org/10.2139/ssrn.2743122>.

²⁹ https://ec.europa.eu/info/news/commission-launches-work-major-research-and-innovation-missions-cancer-climate-oceans-and-soil-2019-jul-04_en

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