

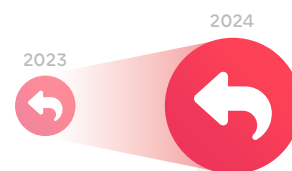


Finance



Wrong direction

Redirecting financial flows towards the transition is essential to put the EU on track to achieve climate neutrality by 2050. This includes both public and private investment flows.











4.9 Finance

Past progress: The development of financial flows towards transition financing in the EU was heading in the **wrong direction** in the assessed period, which means there is no change to the progress classification of last year. This is primarily due to the fact that the climate investment gap for the EU to achieve its climate objectives by 2030 was still significant, amounting to EUR 406 billion in 2022 for the energy, buildings and transport sector. This represents half of the investment that would have to be made every year between now and 2030 to achieve these targets. In the meantime, fossil fuel subsidies increased considerably in 2022 due to the energy crisis, reaching EUR 190 billion. Finally, the quality of information about how banking institutions currently finance and plan to finance the transition was very low, with the quality of the contents of banking transition plans and their timeline of publication still having been uncertain.

Policy context: There are currently no regulations that coordinate an efficient redirection of both public and private financing towards EU climate objectives to close the climate investment gap. However, the EU has implemented several measures, such as carbon taxation through the EU ETS public subsidies, or financial regulation, to redirect financial flows towards a low-carbon economy. The EU’s 8th Environmental Action Programme urged Member States (MS) to phase-out fossil fuel subsidies as soon as possible, but no sanctions are applied to MS if they fail to do so. With the adoption of the Corporate Sustainability Due Diligence Directive (CSRD) in 2023, and the revision of the Capital Requirement Directive (CRD) in 2023, banking transition should become progressively mandatory. The CSRD and CRD, if sufficiently sound and effective, could enable the redirection of private financial flows toward the transition to a low-carbon economy.

Areas of action: Given its significance, the climate investment gap should be better assessed and addressed with urgency, otherwise there is a risk of seeing the Green Deal failing to deliver. It will require comprehensive public policy that involves existing regulation, such as carbon pricing systems, but also public finance schemes and financial regulation to mobilise both public and private investments. An EU long-term climate investment plan could help bridge the gap in climate investment by effectively coordinating public funding and private financing. This is particularly important as the Recovery and Resilience Facility (RFF) is set to end in 2027. To achieve EU climate targets by 2030, it is also essential that MS cease their fossil fuel subsidies as quickly as possible. Finally, although legislative progress has been made in recent years on the obligation for banks to publish transition plans, their publication timeline, and their soundness to effectively enable banks to better finance the transition still need to be clarified.



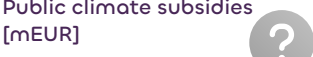




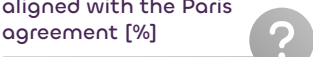
Table 20: Progress in finance towards the objectives and enablers

OBJECTIVE	ENABLERS		
Financing climate change mitigation  	Channelling public funds away from fossil fuels and towards climate neutrality  	Modifying market prices through public intervention  	Shifting private finance towards climate-friendly financing  

Note: Large circles show the progress classification of this year and small circles the one from last year’s progress assessment. Arrows indicate positive or negative changes in classification. See Table 35 for further information.

Source: ©ECNO.

Table 21: Details on indicators' past progress and required change

2023 ▼	2024 >	Historical data			Required change	
		Time period	Relative change p.a.	Absolute change p.a.	Benchmark	Absolute change p.a.
OBJECTIVE: Financing climate change mitigation						
		The Climate Investment Gap [% EU GDP]	2022 (Calipel et al., 2024)	n/a	n/a.	0 (2022) -100%
		Climate-hostile financial flows [mEUR]	n/a	n/a	n/a	n/a
ENABLER 1: Channelling public funds away from fossil fuels and towards climate neutrality						
		Public climate subsidies [mEUR]	n/a	n/a	n/a	n/a
		Fossil fuel subsidies [mEUR 2022]	2017–2022 (OECD & IISD, 2024)	36.3%	21,122.8 mEUR/yr	0 by 2025 -63,461.9 mEUR /yr → needs U-turn
ENABLER 2: Modifying market prices through public intervention						
		Share of GHG emissions covered by a carbon tax [% GHG emissions]	2017–2022 (Fleurence et al., 2023)	3.2%	1.5% -points/yr	n/a n/a
		Revenues from environmental taxation [% total tax revenues]	2017–2022 (Eurostat, 2024u)	-3.4%	-0.4 % -points/yr	10% of total tax revenues by 2020 0.2%-points per year → needs U-turn
ENABLER 3: Shifting private finance towards climate-friendly financing						
		Share of banks with a sound transition plan [%]	n/a	n/a	n/a	n/a
		Share of new banking loans aligned with the Paris agreement [%]	n/a	n/a	n/a	n/a

Note: Icons indicate progress classification of this year's progress assessment and coloured lines the change in classification; See Table 35 for further information. n/a indicates that data are not available.

Source: ©ECNO.

Objective: Financing climate change mitigation

Past progress: Progress towards the objective of financing climate change mitigation was **too slow**. Despite an increase in climate investments in recent years, the EU still faced a substantial investment gap of EUR 406 billion in 2022 (Calipel et al., 2024) for the energy, buildings and transport sector to meet its climate targets by 2030. That represents 2.6% of EU 2022 GDP (Eurostat, 2024r). However, EU climate investments grew by 15% in 2021 and by 9% in 2022, implying a positive development in the climate investment gap (Calipel et al., 2024). At a more granular level, almost all sectors of the EU economy, suffered from climate investment gaps of varying widths. For instance, 2022 investments in wind power represented only 17% of total annual investment needs. Conversely, investments in solar panels already represented 78% of total annual investment needs (Calipel et al., 2024). Furthermore, there is no EU-wide aggregated data available on EU financial flows that contribute to significant GHG emissions. However, it seems likely that the EU is not **on track** of phasing out climate-hostile investments. The IEA (2023g) estimated that USD 122 billion had been invested in fossil fuels on the European continent in 2023. This is 12.3% higher than in 2022. However, the data covers a wider area than just the EU, so that it can only provide a very rough estimate for the EU.

Indicators:

- The Climate Investment Gap
- Climate-hostile financial flows

Policy context: Currently, there are no regulations in place to address the climate investment gap or to decrease climate-hostile investments in a comprehensive way. However, the EU has implemented several measures, such as carbon pricing through the EU ETS or public subsidies, to redirect financial flows towards a low-carbon economy. Without coordination of these public policies, and between their different levels (European, national, local), there is little chance that the climate investment gap will close on its own.

Areas of action: Given its significance, the EC should better assess and address the EU climate investment gap (Calipel et al., 2024), or risks seeing the Green Deal failing to deliver. The EC is already carrying out analyses of investment needs and the climate investment gap, for both the 2030 (EUR 1.2 trillion per year between 2021 and 2030) (EC, 2023ap) and 2040 targets (EUR 1.5 trillion per year between 2031 and 2030) (EC, 2024q). However, the EC's assessment is not updated from year to year. The assessments should be done on an annual basis, and should be needs-driven, accurate, and based on granular data at the EU, national, and local levels. They should also be comprehensive, covering all sectors of the economy. Addressing the climate investment gap requires a comprehensive approach that involves existing regulation, such as carbon pricing systems, public finance schemes or financial regulation. An EU-level long-term climate action financing plan would enable a right articulation of public funding and private financing of the climate investment gap. If the EU granted EUR 254 billion to climate action from the Recovery and Resilience Facility (RFF) funds over the period from 2021 to 2027 (EC, 2023am), these investments will come to an end in 2027. The EU institutions should therefore consider the option of integrating a long-term climate action financing plan in the negotiations for the next EU long-term budget (MFF) for 2028 to 2034.

Enabler 1: Channelling public funds away from fossil fuels and towards climate neutrality

Past progress: There are currently no official aggregated data at the EU level on all climate subsidies. EU climate investment subsidies represent the sum of public subsidies from the EU, its MS, and their local authorities, going towards climate investments. It could include for instance subsidies to renewables, or subsidies to help households renovate their homes, buy an electric car, or install a heat pump. Some partial data exist, for example on subsidies granted to renewable energies. They amounted to EUR 87 billion in 2022, and were well below the level of fossil fuel subsidies for the first time since 2015. Subsidies for renewable energies had increased by 7.3% in 2020 to reach EUR 88 billion. They have remained relatively stable since then (EC, 2023a). The decrease in income and price support schemes (feed-in tariffs, feed-in premiums, etc.) due to the rise in electricity prices (-10.3% in 2021) were compensated by the increase in direct transfer subsidies (mainly grants), which were multiplied by 3 between 2020 and 2022 (EC, 2023a). However, progress towards channelling public funds away from fossil fuels was still going in the **wrong direction** in the period assessed. Fossil fuel subsidies have almost tripled between 2021 and 2022, reaching EUR 190 billion (OECD & IISD, 2024). This growth in fossil fuel subsidies is mainly due to the energy crisis generated by the Ukraine war, which led EU MS to adopt more than 230 temporary subsidy measures to protect households and companies from the rise of energy prices (EC, 2022m) ([see enabler 2](#)).

Indicators:

- Public climate subsidies
- Fossil fuel subsidies

Policy context: The EU's 8th Environmental Action Programme (EAP) urged MS to phase out fossil fuel subsidies as soon as possible. This objective to end all fossil fuel subsidies by 2025 was reaffirmed by European parliamentarians at COP 28 (EP, 2023b). The 8th EAP requires that MS report on their action plan to phase out fossil fuel subsidies on an annual basis. According to these reports, many MS plan to move away from fossil fuel subsidies but only a few have translated these ambitions into laws or clear plans (EC, 2022m). The Energy Taxation Directive (ETD) (2003) still allows fossil fuel subsidies for certain sectors through tax exemptions, in particular for commercial shipping, aviation, and the fisheries sectors. This ETD is currently being revised by the European institutions, with the possibility of ending these exemptions.

Areas of action: To enable the redirection of financial flows from fossil assets to climate neutral ones, it is essential that fossil fuel subsidies are replaced by climate subsidies as soon as possible. More pressure should be put on MS to publish action plans with clear dates for phasing out fossil fuel subsidies and with information about how they will ensure this happens, as already planned in the EU's 8th Environmental Action Programme. Furthermore, the ETD should be revised to exclude the tax exemptions for fossil fuels in the aviation and maritime sectors. Finally, more progress could be made by establishing a clear framework for ensuring long-term climate subsidies. This would provide economic actors with predictability regarding public support for climate investments.

Enabler 2: Modifying market prices through public intervention

Past progress: The share of EU GHG emissions covered by a carbon market price or tax was stable in 2022 (Fleurence et al., 2023) and was overall assessed as **on track**. However, the share of EU and Member States (MS) revenues from environmental taxation were still going in the **wrong direction** in 2022. They represented 4.9% of total EU and MS tax revenues in 2022, against 5.43% in 2021 (Eurostat, 2024u). This decline over the years can be explained by the fact that many MS found it difficult to increase the cost of necessary goods, such as food and energy, by increasing environmental taxes while the country was experiencing social and economic difficulties (EEA, 2023g). The share of revenues from environmental taxation has been falling overall over the last 10 years. In 2013, it represented 6.04% of total revenues from taxation (Eurostat, 2024u).

Indicators:

- Share of GHG emissions covered by a carbon tax
- Revenues from environmental taxation

Policy context: In its Roadmap to a Resource Efficient Europe (EC, 2011), the EC set the objective that each MS should shift their average share of environmental taxation in public revenues to more than 10% (in line with the best performing MS in 2011) by 2020. On average, this target has not been met at the EU level. However, this target is still considered relevant, as environmental taxes encourage producers and consumers to pollute less and use resources more sustainably (EEA, 2023g). Moreover, a significant amount of these revenues must be used towards environmental objectives (at least 50% of EU ETS auctioning must be spent for climate- and energy-related purposes). The share of EU GHG emissions covered by a carbon market price or tax is mainly affected by the decisions by Member States to implement a carbon tax or market in their country, and by the EU ETS framework. The share of EU GHG emissions covered by the EU ETS decreased since 2017, from 39% in 2017 to 36% in 2022. The overall increase in coverage in the EU is mainly due to the introduction of carbon taxation frameworks within the Member States. However, the revision of the EU ETS Directive and the creation of a new ETS (ETS2), including road transport and buildings and adopted by the EP and EC in April 2023, could significantly increase the EU GHG emissions coverage, up to around 80% (Marcu et al., 2023).

Areas of action: Revenues from environmental taxation are still too low within the different Member States compared to what is expected by the EU. In the short term, the situation is unlikely to improve, especially since the EU ETS carbon price has decreased since 2022, from EUR 97 per tonne of carbon dioxide produced in February 2022 to EUR 52 per tonne in February 2024 (Ember, 2024a). In the medium term, the introduction of the ETS2, newly including road transport and building, may bring a response to that, even if ETS prices remain volatile in the absence of carbon price floors. It is important for MS to accompany the increase in environmental taxation with measures to support vulnerable economic groups. This should be the role of the Social Climate Fund, created alongside the ETS2 implementation.

Enabler 3: Shifting private finance towards climate-friendly financing

Past progress: There are currently no available indicators at the EU level that assess the alignment of the financial system with the EU climate neutrality target in a relevant way. Analysing only what exists in the banks' portfolios does not allow for an assessment of their potential to align with the Paris Agreement. What matters is how they plan to finance the decarbonisation of an economy that is still very carbon intensive. There is an urgent need for more transparency on how financial institutions are planning to better finance the transition. Sound transition plans are good instruments to do that (Elderson, 2024). However, these are still not disclosed publicly.

Policy context: Several regulations have taken steps to make banking transition plans mandatory. The Corporate Sustainability Reporting Directive (CSRD), adopted in July 2023, obliges large companies and banks to either publish a sound transition plan by 2025 or indicate the deadline by which they will be able to do so. However, the CSRD now excludes banks' investments and lending activity from the scope of reporting (Green Central Banking, 2024), a change since ECNO's last assessment (ECNO, 2023). This reporting obligation could have further anchored the mandatory nature of the publication of transition plans. Finally, during a trilogue in December 2023, the Council, Parliament and European Commission came to a final agreement on the revision of the Capital Requirements Directive (CRD), which integrates the notion of prudential transition plans for banks. These transition plans should be consistent with the CSRD. By integrating the prudential supervision process, the soundness of banks' transition plans will be more closely monitored by supervisory authorities, such as the European Central Bank. The European Banking Agency (EBA) is expected to propose guidelines on the content and implementation of these banking transition plans in 2024.

Areas of action: Although legislative progress has been made on the obligation for banks to publish transition plans in recent years, nothing is certain yet. The timing of the publication of these plans is still unclear, as is their content, and the capacity of the public authorities to ensure their soundness and implementation. The EBA's guidelines still view banking transition plans as an instrument for risk management alone, with no real strategy for organising the financing of the transition. If these tools are to be effective in enabling banks to redirect their financial flows towards climate finance, it is essential that they are designed to do so. To this end, the EBA's guidelines should ensure that banking transitions plans are linked to European and national strategies, and to the transition plans of the corporates that banks finance. They could also ensure that the remuneration schemes are consistent with the implementation of the plan and that banking teams are sufficiently skilled and qualified to deal with climate issues (I4CE, 2024).

Indicators:

- Share of banks with a sound transition plan
- Share of new banking loans aligned with the Paris agreement