The EU's Global Role
Policy Proposals for a New Era

Maximising the Impact of EU Climate Finance

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SUMMARY

- The EU, when combined with its Member States, is the world's largest provider of climate finance, but its efforts are not having the geopolitical or climate impacts they should.
- Billions of Euros of climate support from the European Commission have not yet been received by partner countries, and the EU's grants for climate projects aren't being targeted towards those which need them most.
- The incoming EU Commission can transform its geopolitical influence by tackling this—at a relatively low cost—in time to make a difference to achieving global net zero.
- The EU must make strategic use of its budget support operations to bolster its climate objectives, and allocate resources to the most vulnerable.
- The EU can improve its climate finance effectiveness and impact by leveraging expertise from across its internal and external departments, development finance institutions, and Member States to create a new approach with a stronger focus on results.
- Towards this aim, we propose that the EU create a climate finance impact taskforce—which would work cross-commission, and with the EU's finance institutions and member states—to drive the improvement of climate finance programming ahead of the next EU budget, accelerate its climate ambition, and report on progress in time for COP30 in Brazil.

What are the issues?

In spite of its climate ambitions—both domestically and internationally—some EU policies have impacted the bloc's credibility as a climate leader, and put a strain on its relationships with developing country partners. Domestically, current emissions per EU resident stand at roughly half the level of those in the US, with the bloc also having ambitious plans for further emissions reductions by 2030. But EU policymakers understand that climate change will necessitate action beyond its own borders, and the EU has also increasingly been externalising major aspects of its European Green Deal. Still, several external aspects of the EU Green Deal have been perceived as introducing new non-tariff barriers, including in agricultural goods, and through its Carbon Border Adjustment Mechanism (CBAM), which is still facing potential legal obstacles within the World Trade Organisation and attracted significant criticism at last year's COP. What's more, EU energy policy following the war in Ukraine, which included a pivot towards securing natural gas supplies

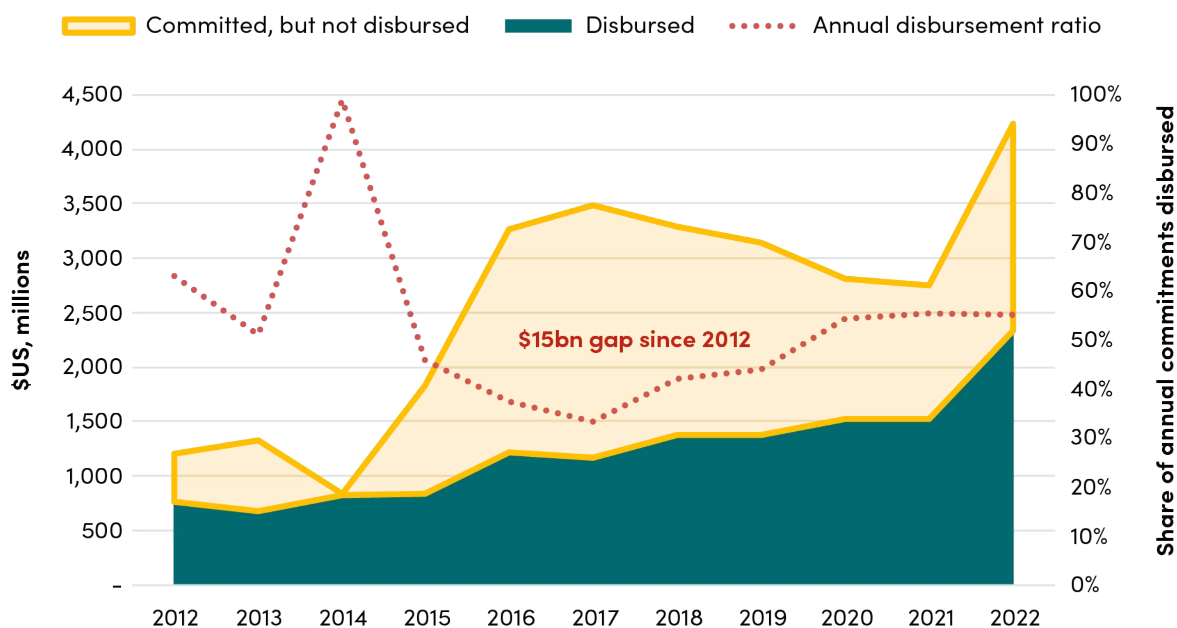
from African countries, has drawn allegations of hypocrisy given the EU's previously negative stand on gas and refusal to invest in "transition" gas projects abroad.

Climate finance is a major diplomatic tool in the EU's arsenal of external climate policies. When combined with its Member States, the EU is the largest global provider of both climate and development finance. EU Institutions rank third among the OECD's Development Assistance Committee (DAC) providers. They are also a major provider of climate finance, targeting global mitigation and adaptation efforts in their own right. They have reported a total of $34.73 billion (EUR 30.66 billion) in bilateral and regional funding to the United Nations Framework Convention on Climate Change (UNFCCC). The EU was also instrumental in overcoming a historical deadlock towards agreeing additional finance for Loss and Damage at COP27—though the EU institutions' own financial pledges for the new fund have come from existing budgets, and aren't new money.

In order to rebuild its reputation as a climate leader, the EU should make credible commitments before or at COP29 to improve the way it spends its climate funds. This would allow it to capitalize on as-yet unrealized opportunities to improve the effectiveness, efficiency, and diplomatic impact of its recently consolidated Neighbourhood, Development and International Cooperation Instrument (NDICI), and feed into the evidence underlying the programming process towards the next, post-2028 Multiannual Financial Framework (MFF). While the EU's current climate finance portfolio shows some significant strengths—including its relatively high concessionality and the channelling of EU funds through local and recipient-owned institutions[1]—three major shortcomings continue to hinder its effectiveness:

First, the EU's committed climate finance is not reaching developing countries. Partner countries are not feeling the benefit of the EU's climate finance on the ground at the scale at which it reports. When cross-referencing climate

FIGURE 1 European Commission' climate-related finance: commitments and disbursements



Source: OECD CRS; data does not include EIB finance, as similar data for MDBs is not available.

Note: The overall volumes of EU climate-related ODA as reported in the CRS are adjusted here in line with its reporting standards for "climate finance" to the UNFCCC. These are based on Rio marker coefficients, with the European Commission counting 100% of its "climate-related" spending marked with a "principal" marker, and 40% of ODA marked with a "significant" climate Rio marker as direct "climate finance" to the UNFCCC. Please also note that the CRS reporting is based on "annualized" commitments, meaning that multi-year project costs are split over the expected project duration, thereby enabling a meaningful analysis of annual disbursement ratios.

finance commitments reported by the EU to the UNFCCC, with OECD data on its actual disbursements, we find that the money being pledged appears not to be materializing, or only appearing after significant delays. These discrepancies erode recipients' trust and reinforce many developing countries' concerns that pledges to support their green transition will not translate into tangible and meaningful action.

The EU's average annual disbursement ratio for climate-marked aid performed poorly, both in comparison to other similar providers and to its wider development budget.[2] On average, the Commission's climate ODA achieved 53 percent in disbursements as a share of annual commitments since 2012, as compared with an average of 97 percent for its non-climate portfolio. The DAC climate ODA average was 69 percent. Non-disbursed EU climate finance commitments since 2012 amount to a total unaccounted-for shortfall of nearly $15 billion (see Figure 1). This exceeds the $13.6 billion which has actually been disbursed by the Commission over the same time period (in teal). Since then, under half (48 percent) of commitments were disbursed. Following 2021, this also has significant implications on whether NDICI can meet its climate spending targets in practice. Thus far, NDICI disbursements have not matched ambitions to spend 30 percent of funds for climate objectives.

Second, the EU's grants—its most concessional resources—are too focused in middle-income countries, insufficiently targeting adaptation and the most vulnerable countries. High interest rates and supply chain volatility mean highly concessional or grant-based finance is most-needed in low-income countries, as well as fragile and vulnerable lower middle-income countries (LMICs). EU institutions do provide a higher share of grant-based climate finance than most other providers, but do not focus those grants on the partner countries that need them most. Between 2015 and 2020, grants accounted for 49 percent of the EU's cumulative climate finance, as compared to the under 30 percent average across all public climate finance providers.[3] The EU institutions' proportion of grants also rose slightly from 40 percent of its climate portfolio in 2015 (at $1.7 billion), up to 48 percent in 2020 ($3.0 billion). While these increases

BOX 1. WHY MIGHT THE EU'S CLIMATE FINANCE LAG ON DISBURSEMENTS: KEY EXAMPLES

While our findings of low disbursement ratios for EU climate finance warrant further investigation, we note two possible contributing factors, based on key examples in the EU's UNFCCC reporting and its prior evaluations of climate projects. First, some EU projects–including several large-scale facilities or trust funds–showed a mismatch between policy and practice, with intentions to mainstream climate objectives leading to overstatements on the climate activities which actually end up taking place. For example, the EU facility for refugees in Türkiye was marked with a "significant" climate objective–accounting for $381 million (EUR 340 million) in grant-based UNFCCC reported finance, yet the facility's monitoring report indicates that only one of its 121 performance indicators had climate implications and that, as of 2020, no progress had been made on this.[a] In another example, a 2022 evaluation of the thematic programme for Civil Society Organisations and Local Authorities—which accounted for at least $220.9 million (EUR 192.6 million) committed since 2018—noted that while climate had received increased policy-level focus, in practice, neither adaptation nor mitigation featured strongly in calls for proposals that were ultimately financed. Second, as noted by an evaluation of climate projects in the EU Neighbourhood, an over-ambitious or "complex" design of some programmes has contributed to substantial and "frequent" delays, leading to climate finance not being disbursed as planned.

a. See Table 4, p. 19, on Indicator 1.2.2.3.

FIGURE 2 Recipients of EU Climate Finance (2015-2020), by share of grants and income level

Source: Authors' analysis of UNFCCC BRS and Annexes, including both EIB and European Commission data.

in grant-based finance—both as a share of the EU climate budget and in absolute terms—are a welcome signal, their distribution is not currently optimal for global climate and development outcomes (see Figure 2). Based on its UNFCCC reporting, just 26 percent of EU climate grants in 2015-2020 went to low-income countries, as compared to 45 percent to regional or global programmes, and 30 percent to middle-income countries. Indeed, the two top recipients of EU climate-related grants—Türkiye and Serbia—were upper middle-income countries, both with strong international credit ratings, relatively low debt-to-GDP ratios, and low scores on international climate risk indices. Worryingly, the share of EU climate grants targeting the poorest countries has also steadily declined, from 29 percent in 2015, to 22 percent by 2020.

Given the immediate pressures on European budgets, it will be essential to enhance the overall efficiency and impact of EU concessional finance by achieving the right balance between grants and loans, and prioritising the most concessional support to countries with the greatest needs. Yet recent evaluations of the EU's climate finance programmes under the previous MFF noted a declining focus on climate vulnerability in allocation criteria, leading to less support for the most vulnerable countries.[4] We also find that the EU's most concessional resources have also been insufficiently focused on adaptation projects. Globally, adaption finance faces larger challenges with attracting non-concessional lending and private investment, with mitigation investments generally considered more "investable" and directly leading to cash-flow generating activities.[5]

Third, EU external climate action would benefit from a more cohesive and policy-driven engagement strategy, including through strategic use of budget support. Currently, EU climate finance, diplomatic efforts, and internal climate agendas often operate in institutional and policy silos. This prevents external climate action from leveraging the full range of EU expertise, networks, and resources. Policy fragmentation also has implications for the coherence of EU climate engagement, with developing country policymakers reporting that they often must engage with different sets of EU stakeholders depending on policy area. With economic dialogues most likely to be prioritized by developing countries, integrating climate into these could provide a more effective avenue for engagement over isolated climate talks. Budget support—and its accompanying policy dialogue—is a key modality where the EU could promote a more ambitious, integrated approach. Greater involvement of recipients' finance, industry, and line ministries within budget support-related policy dialogues could integrate the decarbonization agenda into broader discussions with partner countries. On the EU side, this could also be a good opportunity to engage across DGs towards a more integrated EU climate and development diplomacy.

Despite this, budget support remains underutilised in the EU's climate projects, with reports indicating that less than 1 percent of the EU's budget support operations have had climate as a primary objective (represented by SDG 13). A recent evaluation of climate programmes in the EU Neighbourhood has also called the under-utilisation of budget support for climate a missed opportunity. More widely, an emerging international consensus and research both call for more "programmatic" climate finance, involving more coordination and alignment with recipient governments' policies and budgetary frameworks, and enabling action across multiple sectors in pursuit of more transformational goals. While the EU has historically been a leader on this, its support for "programmatic" modalities–including, but not limited to budget support-have declined within its more recent climate finance, even as most other DAC providers have increased their programmatic support. The OECD DAC tracks such support via its "Programme-Based Approaches" marker. Our analysis of this shows that while in 2014 over 60 percent of EU climate ODA (and over 40 percent of its ODA generally) were "programmatic", after 2020, the share of programmatic climate ODA sharply declined to under 20 percent, even dipping below the DAC average.

Finally, we know that little is known about the impact of climate finance—this is problematic both for recipients; and for EU taxpayers. As one of the largest climate finance providers, the EU has a major stake in ensuring that projects are well-designed and evidence-based. Despite this, previous audits and reviews of EU climate programmes have noted deficiencies in the European Commission's approach to designing monitoring frameworks and evaluating its climate programmes. The upcoming evaluation of the European Green Deal will be an opportunity to review the EU's current approach to the way it designs and learns from climate programmes.

Why should the EU address it now?

The IPCC's recent report highlights that the lack of adequate financing is the greatest barrier to transformative action on climate change. Without a substantial increase in the quantity and quality of international climate finance, limiting global warming to 1.5 degrees Celsius will be unachievable.

At this year's COP29, the Commission will struggle to provide new climate funding without re-badging or re-allocating from other competing priorities, given the structural limitations of its MFF—a scenario which limits the EU's influence, and risks undermining partners' trust. In this context, the EU should signal a focus on tackling the quality of its finance in line with lower- and middle-income countries' calls for a more efficient, transparent, and targeted approach.

What can the EU do about it?

We propose that the Commission should establish an EU climate finance impact taskforce to set out a new approach on monitoring and improving the quality and coherence of EU climate finance, to transform the impact and reputation of the EU's climate finance by:

- Ensuring that pledged EU climate finance reported to the UNFCCC materializes into concrete and climate-relevant projects;
- Enhancing budgetary efficiency by refocusing grant-based climate finance on the poorest recipients and incorporating countries' climate vulnerability into allocation decisions. The Commission should also work together with the European Investment Bank to ensure that its lending operations are better allocated, and that it has the capacity to lend for climate projects to key upper middle-income and high-income EU partner countries;
- Ensuring that the EU's climate finance achieves more transformational impacts by using more programmatic modalities, and prioritising climate within budget support operations and accompanying policy dialogues;
- Aligning and improving climate programme reporting, monitoring and evaluation to ensure that project design enables meaningful aggregation and comparison of results to encourage learning on "what works," building on the upcoming evaluation of European Green Deal.

Taskforce members would have an overarching responsibility for ensuring that the EU's approach on climate finance aligns within the broader framework of European climate diplomacy, and that financial programming is able to leverage the full scope of EU networks and expertise. As such, the Taskforce should comprise members of both external and internal DGs–including those who work on climate, energy, research, or trade policy. It should also include voices from the European External Action Service, EU Delegations, and European development finance institutions and the European Investment Bank. Working-level exchanges between officials—who may currently hold very different technical understandings of what makes climate and development action effective—could help to ensure that cross-institutional capacities, knowledge, and skills related to both climate and development are being built within the EU.

Endnotes

1 For more on the EU's strengths in concessionality, see the section on concessionality within this note. As regards the latter, we found considerable improvements in the EU's dedication to channelling climate-related development funding through recipient-owned institutions since 2014, and the EU performs better than most bilateral providers on ensuring that local institutions—including subnational or central governments, local authorities, or civil society organisations—are the ones who are directly responsible for the funds. By supporting recipient ownership and helping to build the capacity of local institutions, the EU contributes to the long-term sustainability of its climate programmes.

2 Indeed, low disbursement ratios for climate—defined as the annual share of commitments which materialise as disbursements—in climate finance have previously been noted as an issue affecting other climate providers.

3 Calculated based on Figure 3 in OECD Aggregate Climate Finance Report

4 Although the majority of the EU's climate support is now provided under a "geographized" NDICI-GE instrument, it is not clear to what extent climate vulnerability is being considered under thematic or other remaining envelopes.

5 A further 33% was spent on "cross-cutting" priorities, and 27% of EU climate grants exclusively targeted mitigation. Of the total EU climate portfolio—including both grants and loans- only 23% was spent on adaptation, 19% on "cross-cutting" priorities, and 57% on mitigation.

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This brief is part of series, The EU's Global Role: Policy Proposals for a New Era. The series will set out a suite of policy proposals designed to shape the international development agenda of the European Union's leadership during the 2024-2029 term.

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