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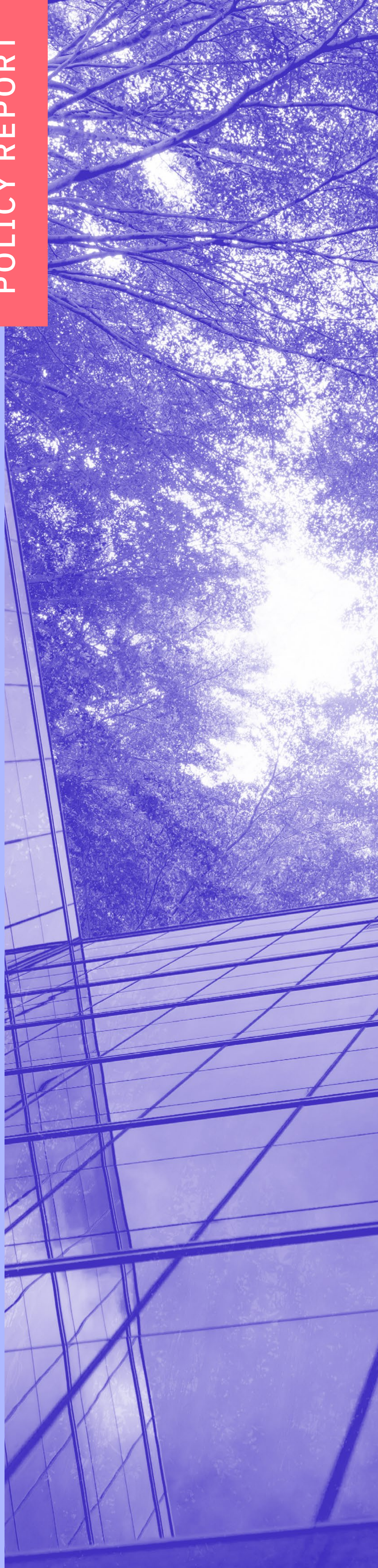
POLICY REPORT



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The EU's sustainable finance agenda: recommendations for a fair and competitive transition

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This report is part of Friends of Europe's Climate, Energy and Natural Resources programme. Written by Luke O'Callaghan-White and Davide Sofia, it has based on the outcome of a series of meetings and discussions under the sole responsibility of Friends of Europe. The authors and the participants contributed in their personal capacities, and their views do not necessarily reflect those of the institutions they represent, nor of the Friends of Europe board of trustees, its members or partners.

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Contents

Executive summary

We know that additional annual investments of approximately €620bn will be needed to meet the objectives of the Green Deal and the REPowerEU Agenda, and further annual investments of €92bn to reach the EU’s green industrial targets. Hence, the activities in the financial sector will significantly impact the ecological transformation to a climate-resilient and net-zero future.

Between October 2023 and February 2024, Friends of Europe convened three coordinated and bespoke meetings on sustainable finance with the aim of fostering new thinking on the future of sustainable finance in the EU.

In this report, we make three proposals to strengthen the EU sustainable finance agenda, during the next European institutional cycle, from 2024-2029.

Firstly, **we recommend that policymakers re-examine the relationship between sustainability and competitiveness**. We argue that the benefits of policy certainty and market predictability associated with the EU’s clearly defined long-term sustainability targets play an important role in supporting European competitiveness. While certain EU policymakers are calling for a regulatory pause in sustainability measures, we highlight the economic benefits of maintaining the commitment to the ecological transformation.

Secondly, **we recognise the development of the EU’s sustainable finance agenda, but argue that adjustments to its governance framework are needed**. In particular, we outline how policymakers in the next EU mandate could take a leadership role on transition finance – the key frontier in sustainable finance. We also emphasise the need to revise existing pieces of legislation to combat greenwashing, and highlight the importance of more responsive governance and improved policy coordination among actors for better implementation of the sustainable finance agenda.

Finally, **we recommend that the next EU mandate place greater emphasis on the socio-economic dimensions of the net-zero transition**. We argue that policymakers should support an equitable shift to a net-zero future to meet critical social obligations but also to maintain public support for the European Green Deal. Hence, in this report, we argue that a *resilient* transition is a just transition, and where social and economic equity concerns should be mainstreamed in the EU’s sustainable finance agenda.

Introduction

The ecological transformation to a climate-resilient and net-zero future will, to a significant extent, be determined by activities in the financial sector.

Between October 2023 and February 2024, Friends of Europe convened three coordinated and bespoke meetings on sustainable finance with the purpose of fostering new thinking and devising recommendations to strengthen the EU sustainable finance framework. This project sat within the broader stream of activities that Friends of Europe is undertaking to bolster a fair green transition. This series of engagements brought together a diverse collection of stakeholders, including senior figures from across the European institutions; leading representatives from the private sector; renowned academics; and a broad group of senior figures from civil society organisations across Europe.

By bringing together cross-sectoral stakeholders, Friends of Europe sought to open up new avenues for discussion and debate. The two roundtable discussions were held under the Chatham House Rule. This helped to facilitate frank discussions among the participants who, while working on similar issues albeit from different vantages, were seldom in such a forum where this broad range of diverse perspectives on the future of sustainable finance were present together.

One of the objectives of convening these engagements was to help participants better grasp the different narratives used by others around the table. Overall, the organisation of these three engagements – two roundtable meetings and one public panel discussion – was to foster fresh thinking and build action-focused networks across sectors and to generate action-oriented recommendations for the future of sustainable finance in the EU.

[1] Word clouds need to be updated for parts b,c of 24.10 dinner and a,b,c of 9.11 roundtable

Context – Sustainable finance: a critical piece to the net-zero puzzle

The European Commission estimates that additional annual investments of more than €620bn will be needed to meet the objectives of the Green Deal and the REPowerEU Agenda, while further annual investments of €92bn will be needed to reach the EU's green industrial targets.[1]

Mid-way through, what has widely been referenced as 'the decade of decisive climate action', the EU remains off-track to meet its 2050 commitments. Climate action will, thus, need to accelerate in the second half of this crucial decade. Recalibrating finance in this context will be important, not least for addressing the aforementioned investment gap, mitigating climate risk in the system, and incentivising the transition of high-emitting sectors of the economy towards lower-carbon and eventually net-zero alternatives.

In the context of advancing the decarbonisation of the EU economy in the next EU mandate from 2024-2029, **developing the sustainable finance architecture will be pivotal in advancing the transformation to a resource-efficient, climate-resilient and net-zero economy**.

Since 2018, when the European Commission published its action plan on sustainable finance, there have been a number of new legal and regulatory measures, including the EU Taxonomy, the Sustainable Finance Disclosure Regulation and the European Green Bond Standard. Public investment from the EU, through initiatives such as the InvestEU programme, are important but the current green investment gap cannot be bridged without the large-scale mobilisation of private capital.

The priorities of the EU's sustainable finance framework are threefold:

1. to reorient capital flows to align with the net-zero objectives;
2. mainstream climate objectives and sustainability into risk management; and
3. enhance transparency through disclosures and reporting for companies and investors.[2]

While this sustainable finance framework, and the associated legislative developments, make it easier for public bodies to raise capital, the primary objective of the rubric is to support the flow of private financial investments to sectors of the economy that are aligned with the European Green Deal.[3]

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[1] European Commission. (2023). Press corner: Questions and Answers on the Sustainable Finance Package. European Commission. https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3194

[2] Invest Europe. Sustainable Finance library. https://www.investeurope.eu/policy/key-policy-areas/sustainable-finance/

[3] Communication 2021/390. *Communication (EU) No 2021/390 from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Strategy for Financing the Transition to a Sustainable Economy.* 6 July 2021. https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52021DC0390&from=BG

Over the last decade, there has been considerable growth in environmental, social and governance (ESG) investments, with sustainability factors now a mainstream of investment decision-making.[4] This trend can, in main, be understood as a result of growing appreciation among corporations and financial institutions that the climate transition and the physical risks associated with climate change will affect the long-term performance of investments and financial stability and that action is needed to mitigate these risks.[5] [6]

Redirecting capital flows towards economic activities aligned with the net-zero target can also serve to strengthen the social dimensions of this transition by supporting climate-vulnerable populations and economically peripheral regions of the continent. To achieve more comprehensive impact, however, these positive trends in ESG investments need to also have a real economy impact.[7]

The major sustainable finance developments since 2018 have primarily focused on enhancing transparency,[8] one of the three aforementioned pillars of the EU's sustainable finance framework. A more comprehensive sustainable finance landscape will require packages to support the other two priorities.

It is in this context that Friends of Europe has sought to contribute to the development of new thinking with respect to sustainable finance in the EU.

[4] International Financial Reporting Standards. International Sustainability Standards Board. https://www.ifrs.org/groups/international-sustainability-standards-board/

[5] Boffo,R. and R.Patalano. (2020). ESG Investing: Practices, Progress and Challenges. OECD Paris. www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf

[6] European Central Bank. Banking Supervision (2020). Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure. https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf

[7] The 'real economy' refers to all the non-financial elements of an economy.

[8] Vandeloise, V. (2024) A guide to the next sustainable finance agenda. Limitations of the current framework and recommendations for an effective transition. *Finance Watch.* https://www.finance-watch.org/wp-content/uploads/2024/01/a-guide-to-the-next-sustainable-finance-agenda.pdf

The role for Friends of Europe

Between October 2023 and February 2024, Friends of Europe brought together cross-sectoral figures, involved in the development of EU sustainable finance policy, for three constructive engagements. These gatherings were opportunities for representatives from the EU institutions, the private sector and civil society organisations to highlight the successes and shortcomings of the EU sustainable finance framework.

This chapter recalls the key insights from this series of bespoke engagements on the European sustainable finance agenda. Here, we consider the different narratives and points of emphasis presented by the various stakeholders represented.

Policymakers and representatives from civil society organisations emphasised the importance of social and economic considerations when it comes to the transformation to climate-neutrality. Among all the participants, these stakeholders stressed the need to prioritise the wellbeing of citizens, especially those in the most vulnerable areas and in the most carbon-intensive sectors. As one policymaker put it: “If the previous term was about ambition and making this a Green Deal term, the next term is about making sure that this is a good deal for everybody.”

European policymakers and civil society stakeholders, in particular, also highlighted the threat that political polarisation around sustainability measures poses to EU policy coherence. Many of the political figures and NGO voices in attendance were clear that fostering political buy-in and preventing a Green Deal U-turn, rests firmly on the perception of fairness in the transition.

In contrast, private sector representatives who engaged in these three meetings emphasised their concerns with the existing legislative framework, and argued that EU policymakers should prioritise improving the sustainable finance architecture to ‘better enable’ the flow of capital towards sustainable economic activities. In highlighting the characteristics of such an enabling regulatory regime, one representative from the private sector clarified that, “it is a framework that standardises and harmonises in a rational way to level the playing field, allowing sufficient competition and the possibility as well for front-runners to draw rightful profits from their initiatives.”

These private sector actors also raised issues regarding the availability of financial incentives and the EU’s competitiveness, as areas where the EU sustainable finance agenda can be improved.

There was broad consensus among all the stakeholders convened that data availability and the quality of existing data on many sustainable finance indicators presents serious problems for the EU's agenda. As was highlighted by actors from the European institutions and the private sector, these data concerns are most stark when one considers the activities of small and medium enterprises (SMEs), in turn, making it very challenging to assess their progress in the transition. This is a major issue for the EU's sustainable finance agenda given that 99% of businesses in the EU are SMEs.[9]

In the next chapter, we outline three recommendations to strengthen the EU' sustainable finance agenda over the course of the next institutional mandate, which begins following the European Parliament elections in June 2024. The three coordinated meetings have informed the recommendations that we will present in the following chapter. They do not reflect a singular point of view nor of one particular sector that was represented at these gatherings. Rather, they are action-oriented proposals to strengthen the EU's sustainable finance agenda, which can also support the delivery of a just transition to net-zero emissions.

[9] Commission Recommendation 2003/361/EC. *Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises.* 20 May 2003. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32003H0361

Recommendations for the next EU mandate

RECOMMENDATION 1: re-examine the relationship between sustainability and competitiveness

The financial, political and economic landscape in 2024 is profoundly different to that of 2019, when the current EU mandate began. The disruption caused by the COVID-19 pandemic, the Russian invasion of Ukraine and ratcheting geoeconomic tensions between Europe and China have had significant impacts on inflation and interest rates, financial stability and the price of essential goods, and political attitudes, more broadly.

In 2024, as inflation falls, European policymakers are shifting focus to the challenge of EU competitiveness. For nearly three decades, average productivity growth has been weaker in the EU, compared with other economies.[10] In the context of the US Inflation Reduction Act and the growing gap between the EU and its peers when it comes to transversal technologies, there are concerns that the EU is lagging behind other economies in the digital and green transition.

The approach taken to this political and economic tumult by some European leaders, most notably French President Emmanuel Macron,[11] has been to call for a regulatory pause on environmental legislation to focus on addressing competitiveness in Europe. More broadly, there is a burgeoning threat to the political support of the European Green Deal as public support for certain policy measures declines and protests become more frequent.

A pause in new environmental regulation may seem like an expedient and politically savvy measure to quell Green Deal unrest among specific constituencies, but such an approach threatens to weaken the EU's competitiveness, not enhance it. Pausing, and thus prolonging, necessary climate action will increase the costs associated with the transition, hurt economic growth and will require more intensive intervention at a later date.[12] [13]

Furthermore, halting progress on a long-term climate ambition because of short-term factors would send an important yet negative signal to market actors. Clear, coherent and predictable indications from lawmakers regarding the direction of travel are important to foster private investment. **Policy certainty and predictability**

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[10] Communication 2023/168. *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Long-term competitiveness of the EU: looking beyond 2030.* 16 March 2023. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52023DC0168

[11] Di Sario, F. and Leali, G. (2023) *Macron's call for 'regulatory pause' in EU environmental laws wink at conservatives.* Politico. https://www.politico.eu/article/emmanuel-macron-the-eu-sophies-choice-moment-juggling-growth-and-the-environment/

[12] Carton, B. and Natal, J.M. (2020). Further Delaying Climate Policies Will Hurt Economic Growth. *IMF Blog.* https://www.imf.org/en/Blogs/Articles/2022/10/05/further-delaying-climate-policies-will-hurt-economic-growth

[13] Emambakhsh, T., Fuchs, M., Kordel, S., Kouratzoglou, C., Lelli, C., Pizzeghello, R., Salleo, C. & Spaggiari, M. (2023). The Road to Paris: stress testing the transition towards a net-zero economy. ECB Occasional Paper, (2023/328).

that regulatory changes will not simply be revoked or upended, are needed to foster long-term private investment strategies in the EU. By sticking the course and supporting the implementation of a deep sustainable finance framework, the EU can distinguish itself as a beacon of policy certainty for sustainable finance at a time when unpredictability and uncertainty abound.

Indeed, recognition as an international vanguard of a robust sustainable finance framework with a commitment to its improvement can be seen as strengthening the competitiveness and resilience of the European economy.

RECOMMENDATION 2: **adjust the EU governance framework for sustainable finance**

Despite the progress made since the launch of the sustainable finance framework in 2018, we see a continued outsized investment in high-emitting sectors at the expense of those sectors aligned with net-zero pathway and the EU’s framework is still lacking a focus on climate adaptation and safeguarding of nature and biodiversity. It is clear that considerable work remains to assemble a more holistic infrastructure based, not just on decarbonisation, but on a systems-transformation more broadly.

Nonetheless, policy leaders in the next EU mandate from 2024-2029, could make important changes to improve the governance of the sustainable finance framework as it exists now, which would have positive outcomes.

Transition finance

The EU has benefited from being one of the first movers in taking serious measures regarding climate action.[14] In 2024, there is an opportunity for the EU to continue its commitment to charting a path to net-zero emissions by taking a global leadership role on transition finance[15] – the key frontier in sustainable finance.

In the EU, much of the focus in this area since 2018 has been on supporting the capital flow into sectors of the economy that are aligned with the EU Taxonomy – green finance. This has come at the expense of efforts to support high-emitting industries and companies rapidly decarbonise and become aligned with the net-zero objective. In sectors such as food production, the built environment and more broadly the development of infrastructure, green financial activities as recognised by the EU Taxonomy proved to be a small niche that lacks the traction to trigger the transition of the entire economy.

[14] Karkatsoulis, P., Capros, P., Fragkos, P., Paroussos, L., & Tsani, S. (2016). First‐mover advantages of the European Union’s climate change mitigation strategy. International Journal of Energy Research, 40(6), 814-830.

[15] Transition finance can be understood as: the provision and use of financial products and services to support counterparties, such as companies, sovereigns, and individuals, realise alignment with environmental and social sustainability” from Caldecott, B. (2022). Defining transition finance and embedding it in the post-Covid-19 recovery. Journal of Sustainable Finance & Investment, 12(3), 934-938.

Critics of the approach taken to-date have argued that the EU's sustainable finance framework misses a key point: it's not about being green but becoming green. On this point, in 2022 the Platform on Sustainable Finance has suggested to reform the EU Taxonomy to include economic activities with negative, intermediate and low impacts on the environment, thus moving away from the dichotomy of green/non-green and positively impact companies' capacity to fund their transition.

In June 2023, the European Commission published a communication on 'transition finance', which reflects a 'starting point' rather than a coherent approach that can be embedded in the existing regulatory framework.[16] [17]

A pivot in the focus of the framework to transition finance is imperative because a net-zero future will require the decarbonisation of heavy-emitting industries; green finance alone will not be sufficient.[18]

Given the size of the current green investment gap, and the speed at which it needs to be closed in order to realise binding climate and sustainability objectives, it would be prudent for the next European mandate to prioritise transition finance, ensuring that it is better integrated into its regulatory files.

In updating its 2023 communication, the European Commission could emphasise the importance of transition plans as a necessary condition for transition finance and as a tool to mitigate financial risk and avoid stranded assets during decarbonisation. The publication of credible transition plans by heavy-emitting firms is important for the long-term investment landscape in Europe. They could help to ensure that patient capital takes centre stage in Europe, and, if designed appropriately can guide the design of bonds and loans.[19]

Currently, there is no global standard for transition plans. The EU could again seize the benefits of being a first mover in developing a comprehensive rubric for sustainable finance and propose at, say the Financial Stability Board, or the G20, a template for a credible transition plan. This could support the decarbonisation of those entities outside of the EU and in jurisdictions with a less developed sustainable finance framework.

Responsive governance for better implementation

Many analysts and market actors have called for a pause in the promulgation of new regulations in the sustainable finance agenda to allow for focus on better implementation of existing measures. However, some of the crucial improvements to the EU's sustainable finance architecture, as outlined above, may require new

[16] E3G. (2023). New EU Commission Sustainable Finance Package. Press Releases. https://www.e3g.org/news/new-eu-commission-sustainable-finance-package/

[17] Donnachie, L. (2023). What next for the EU Green Deal and European Commission climate agenda?. *The Institutional Investors Group on Climate Change: IIGGC*. https://www.iigcc.org/insights/what-next-for-the-eu-green-deal-and-european-commission-climate-agenda

[18] Harnett, E., Holland, T. and Kessler, L. (2023). Defining Transition Finance: Exploring Its Purpose, Scope and Credibility. *Rocky Mountain Institute.* https://rmi.org/defining-transition-finance-exploring-its-purpose-scope-and-credibility/

[19] Lehmann, A. (2023). Mobilising transition finance will require credible corporate climate plans. *Bruegel*. https://www.bruegel.org/analysis/mobilising-transition-finance-will-require-credible-corporate-climate-plans

pieces of legislation. This is not to discredit the calls for more concerted effort regarding the implementation of existing legislation. Indeed, policy-makers in the next EU mandate will need to modify and improve elements of the regulatory toolbox on a case-by-case basis.

Many legislative packages covering sustainable finance have taken effect in the twilight of this European mandate. For instance, the Corporate Sustainable Reporting Directive has entered into effect only since 2023, and the financial disclosure reporting requirements for market participants, covered by the Sustainable Finance Disclosure Regulation, will be required by June 2024.

Research from the organisation *Finance Watch* shows that in order to both achieve the stated aims of the sustainable finance agenda and ensure credibility of transition plans, weaknesses and loopholes in the current set of tools must be remedied.[20]

The Commission is not eager to make such concrete amendments at this juncture, highlighting that it is still too early to draw firm conclusions on the sustainable finance framework.[21] However, in the coming mandate, it would be prudent for policy-makers to avoid entering a sunk-cost fallacy, and instead be proactive in making adjustments in response to the natural teething challenges associated with implementation and reporting requirements. **Improved agility by the European Commission in this regard would send a positive signal to market actors and could increase confidence in the durability of the EU's commitment to strengthening the sustainable finance agenda in the long-term.**

Combatting greenwashing

One important area where modifications to existing legislation will surely be needed is in addressing greenwashing. In 2023, the European Supervisory Authorities (ESAs) put forward a common definition of 'greenwashing', which is applicable to market participants across their respective remits.[22] While the ESAs recognise that greenwashing can arise intentionally or unintentionally,[23] it is nonetheless concerning that between 2022 and 2023 banks and financial services saw an increase of 70% in the number of climate-related greenwashing incidents.[24] This indicates that there is a broken relationship between what many actors claim to be doing and what is actually done. Even if regulations such as the EU Taxonomy are

[20] Vandeloise, V. (2024) A guide to the next sustainable finance agenda. Limitations of the current framework and recommendations for an effective transition. *Finance Watch*. https://www.finance-watch.org/wp-content/uploads/2024/01/a-guide-to-the-next-sustainable-finance-agenda.pdf

[21] Friends of Europe. (2024). Reframing finance: a systems-led approach to sustainable investment. https://www.friendsofeurope.org/events/reframing-finance-a-systems-led-approach-to-sustainable-investment/

[22] Greenwashing is understood as: *a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants.* From European Securities and Markets Authority. (2023). Progress Report on Greenwashing. https://www.esma.europa.eu/sites/default/files/2023-06/ESMA30-1668416927-2498_Progress_Report_ESMA_response_to_COM_RfI_on_greenwashing_risks.pdf

[23] Ibid.

[24] RepRisk. (2023). On the rise: navigating the wave of greenwashing and social washing. https://www.reprisk.com/news-research/reports/on-the-rise-navigating-the-wave-of-greenwashing-and-social-washing/20adb3d8

in place, and financial products obtain labels related to sustainability by following the ESG criteria, the incidence of greenwashing is still concerning. Reducing levels of greenwashing will necessitate a re-think of the role of financial regulators and the tools needed to associated strengthen accountability mechanisms. Hence, **eliminating greenwashing in banking and the financial services will require improvements to pieces of EU legislation and the better implementation of existing regulations.**

The high-incidence of greenwashing claims in the banking sector may be a reflection of the mismatch between 'green labels' attributed to financial products and the activities in the real economy, which they fund, and which are frequently a lot less 'green'.

Improving policy coordination in the framework for Sustainable finance

Climate change poses both physical and transition risks to the European economy. These types of risks are in a complex and mutual interaction with macroeconomic policy and the financial system of the EU. Improving coordination among the EU main funding instrument and solving the flaws of the current European institutional framework, for instance by completing the Capital Markets Union (CMU), will be essential to support the green transition and the alignment with the climate-neutrality targets.

At the European level there is a great potential to further increase policy coherence in the sustainable finance agenda, while developing the capacity of many instruments, such as the Recovery and Resilience Facility (RRF), the main funds under Cohesion Policy and InvestEU to deploy climate investments.[25] Indeed, with the NextGeneration EU, the Union has tried to reduce fragmentation by improving its economic policy with fiscal tools that allow member states to benefit collectively in the international capital markets.

In addition, the EU has addressed the necessity for a standard in green investments, with the development of the EU green bonds. These financial instruments are consistent with the plan to complete the CMU and are conducive to greater integration of capital markets. Indeed, green bonds are already more likely to be held across borders compared to other bonds issued in the euro area.[26] In this regard, the public sector has a significant role. By issuing green bonds, governments will play an essential role to leverage private finance.

Based on our aforementioned engagements with a diverse set of stakeholders, we propose three concrete actions that would enhance policy coherence in the

[25] E3G, ShareAction, WWF, (2024). Investing in Europe's prosperity: A vision for financing the transition to sustainability 2024-2030. https://www.e3g.org/wp-content/uploads/E3G-ShareAction-WWF-Report-Investing-in-Europes-prosperity.pdf

[26] European Central Bank. (2021). Towards a green capital markets union: developing sustainable, integrated and resilient European capital markets. https://www.ecb.europa.eu/press/financial-stability-publications/macroprudential-bulletin/focus/2021/html/ecb.mpbu_focus202110_3.en.html

sustainable finance framework.

- *Enhance financial supervision.* Financial supervision is especially significant for what concerns the transition to climate neutrality, as, with the unpredictability of extreme weather events and climate-related asset stranding, exposure to this type of risk becomes an important element for evaluation.

- *Provide the right incentives.* The EU needs to focus on incentives to banks and other financial institutions to diversify their portfolios and increase awareness and consideration of climate-related financial risks.

- *Foster strong collaboration and complementarity between public and private streams of funding.* The investments required to reach climate neutrality can only be catalysed by capital markets in conjunction with bank lending and public investments.

RECOMMENDATION 3: **place greater emphasis on the socio-economic dimensions of the transition**

The sustainable finance agenda was designed with the aim of accelerating the decarbonisation of the real economy. However, the relationship between sustainable finance and the real economy is less clear-cut.

Research shows that holding green financial assets is insufficient for investors to impact the real economy,[27] and that ESG integration impacts the real economy to varying degrees and only under specific conditions.[28] The extent to which sustainable finance is ushering a direct transformation of the real economy is, therefore, not clear and is worthy of further analysis.[29] Examining this relationship is important for maintaining public support for the European Green Deal. The incongruity of strong sustainability reports across banking, insurance and pensions, and financial markets, while greenhouse gas emissions continue to rise in the real economy will likely sow distrust in the EU's entire sustainable finance agenda.

As the European Green Deal begins to be translated into policies that affect people's lives, we have seen the increasing politicisation of climate politics, and this is likely to continue ahead of the European Parliament elections in June 2024.

The creation of a European Green Deal – a framework to generate systemic change and align the EU economy with planetary boundaries was a milestone achievement of the outgoing European Commission. As the incoming mandate navigates a more

[27] Caldecott, B.L., Clark, A., Harnett, E., Koskelo, K., Wilson, C., & Liu, F. (2022), Sustainable Finance and Transmission Mechanisms to the Real Economy. *University of Oxford Smith School of Enterprise and the Environment.* Working Paper 22-04.

[28] Heeb, F., Kellers, A., & Kölbel, J. (2022). Does ESG integration impact the real economy. A theory of change and review of current evidence Commissioned by the *Swiss Federal Office for the Environment* (FOEN).

[29] Caldecott, B.L., Clark, A., Harnett, E., Koskelo, K., Wilson, C., & Liu, F. (2022), Sustainable Finance and Transmission Mechanisms to the Real Economy. *University of Oxford Smith School of Enterprise and the Environment.* Working Paper 22-04.

fractured political landscape, climate policies will need to emphasise the incentives of re-orienting action towards sustainable alternatives and not simply highlight the perils of inaction. Addressing the socio-economic dimensions of the net-zero transition will be important in this regard.

An equitable and fair shift to a net-zero future will meet important social obligations but will also help to maintain public support for the European Green Deal. Ensuring a just transition towards climate-neutrality is predicated on, but not limited to, the availability of financial supports and coherent public investment to ensure that regions and marginalised groups in society are not left behind. There is also an evident need to ensure that there is a greater injection of private capital aligned with net-zero emissions, in such peripheral regions, to support this broader aim of an equitable transformation of the economy to net-zero emissions by 2050.

The different instruments of the EU's sustainable finance framework are supposed to be mutually reinforcing, yet it is not clear that it is functioning in such a way, at present.[30] **The next EU mandate could strengthen these various threads and work towards a more holistic understanding of sustainable finance measures, which includes social sustainability, human rights and the just transition.**

[30] Signe Andreasen Lysgaard, Senior Advisor for Human Rights and Business Department at the Danish Institute for Human Rights, in Friends of Europe. (2024). Reframing finance: a systems-led approach to sustainable investment. https://www.friendsofeurope.org/events/reframing-finance-a-systems-led-approach-to-sustainable-investment/

Conclusion

The development of the EU sustainable finance framework has been important in helping to recalibrate finance towards activities that are aligned with the European Green Deal. As was highlighted in the three engagements convened by Friends of Europe, the transition to a resource-efficient and climate-neutral future is a systemic change. Therefore, social and economic equity concerns need to be at the core of this journey. A people-centred approach to climate action is not a pithy soundbite but a recognition that a resilient transition to net-zero is a just transition.

At this inflection point for EU competitiveness, a clear and important message that emerged from our engagements was the argument that, by maintaining a commitment to sustainability and green transition measures, the EU could in fact strengthen its competitiveness. However, it is clear that there is also a significant 'narrative gap' and, thus, it will be essential that in the next EU mandate there is a coordinated effort among stakeholders to address a prevailing attitude which posits that support for climate measures and support for competitiveness are mutually exclusive and incompatible policy aims.

By grasping the opportunity to address this narrative gap, improving existing sustainable finance measures and addressing the social implications of the sustainable finance framework, the next EU mandate can take meaningful strides towards the transformation to a climate-resilient and net-zero economy.

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